

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 20-F**

(Mark One)

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Date of event requiring this shell company report

For the transition period from to

Commission file number: 001-32371

SINOVAC BIOTECH LTD.

(Exact name of Registrant as specified in its charter)

N/A

(Translation of Registrant's name into English)

Antigua, West Indies

(Jurisdiction of incorporation or organization)

**No. 15 Zhi Tong Road,
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People's Republic of China**

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(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

| Title of each class | Name of each exchange on which registered |
|--|---|
| Common Shares, par value \$0.001 per share | The NASDAQ Stock Market LLC |
| Preferred Share Purchase Rights | (The NASDAQ Global Select Market) |

Securities registered or to be registered pursuant to Section 12(g) of the Act:

None

(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None

(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.
57,281,861 common shares as of December 31, 2017

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or an emerging growth company. See definition of "large accelerated filer," "accelerated filer," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer
Emerging growth company

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards[†] provided pursuant to Section 13(a) of the Exchange Act.

[†] The term "new or revised financial accounting standard" refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012.

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP

International Financial Reporting Standards as issued by the International Accounting Standards Board

Other

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

(APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PAST FIVE YEARS)

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes No

CONTENTS

| | | |
|---------------------|---|-----------|
| <u>INTRODUCTION</u> | | <u>1</u> |
| <u>PART I</u> | | <u>1</u> |
| <u>ITEM 1.</u> | <u>Identity of Directors, Senior Management and Advisers</u> | <u>1</u> |
| <u>ITEM 2.</u> | <u>Offer Statistics and Expected Timetable</u> | <u>1</u> |
| <u>ITEM 3.</u> | <u>Key Information</u> | <u>1</u> |
| <u>ITEM 4.</u> | <u>Information on the Company</u> | <u>34</u> |
| <u>ITEM 4A.</u> | <u>Unresolved Staff Comments</u> | <u>50</u> |
| <u>ITEM 5.</u> | <u>Operating and Financial Review and Prospects</u> | <u>50</u> |
| <u>ITEM 6.</u> | <u>Directors, Senior Management and Employees</u> | <u>67</u> |
| <u>ITEM 7.</u> | <u>Major Shareholders and Related Party Transactions</u> | <u>76</u> |
| <u>ITEM 8.</u> | <u>Financial Information</u> | <u>77</u> |
| <u>ITEM 9.</u> | <u>The Offer and Listing</u> | <u>81</u> |
| <u>ITEM 10.</u> | <u>Additional Information</u> | <u>82</u> |
| <u>ITEM 11.</u> | <u>Quantitative and Qualitative Disclosures about Market Risk</u> | <u>93</u> |
| <u>ITEM 12.</u> | <u>Description of Securities other than Equity Securities</u> | <u>93</u> |
| <u>PART II</u> | | <u>93</u> |
| <u>ITEM 13.</u> | <u>Defaults, Dividend Arrearages and Delinquencies</u> | <u>93</u> |
| <u>ITEM 14.</u> | <u>Material Modifications to the Rights of Security Holders and Use of Proceeds</u> | <u>94</u> |
| <u>ITEM 15.</u> | <u>Controls and Procedures</u> | <u>94</u> |
| <u>ITEM 16A.</u> | <u>Audit Committee Financial Expert</u> | <u>96</u> |
| <u>ITEM 16B.</u> | <u>Code of Ethics</u> | <u>96</u> |
| <u>ITEM 16C.</u> | <u>Principal Accountant Fees and Services</u> | <u>97</u> |
| <u>ITEM 16D.</u> | <u>Exemptions from the Listing Standards for Audit Committees</u> | <u>97</u> |
| <u>ITEM 16E.</u> | <u>Purchases of Equity Securities by the Issuer and Affiliated Purchasers</u> | <u>97</u> |
| <u>ITEM 16F.</u> | <u>Change in Registrant's Certifying Accountant</u> | <u>97</u> |
| <u>ITEM 16G.</u> | <u>Corporate Governance</u> | <u>97</u> |
| <u>ITEM 16H.</u> | <u>Mine Safety Disclosure</u> | <u>97</u> |
| <u>PART III</u> | | <u>97</u> |
| <u>ITEM 17.</u> | <u>Financial Statements</u> | <u>97</u> |
| <u>ITEM 18.</u> | <u>Financial Statements</u> | <u>97</u> |
| <u>ITEM 19.</u> | <u>Exhibits</u> | <u>98</u> |

INTRODUCTION

In this annual report on Form 20-F, unless otherwise indicated or unless the context otherwise requires,

- “Sinovac,” “Sinovac Biotech,” “Company,” “we,” “us,” “our company,” and “our” refer to Sinovac Biotech Ltd., its predecessor entities and its consolidated subsidiaries
- “China,” “Chinese” or the “PRC” refers to the People’s Republic of China, excluding, for the purposes of this annual report on Form 20-F only, Taiwan and the special administrative regions of Hong Kong and Macau;
- “RMB” or “renminbi” refers to the legal currency of China; and “\$” or “U.S. dollars” refers to the legal currency of the United States;
- “shares” or “common shares” refers to our common shares, par value \$0.001 per share; and
- “U.S. GAAP” refers to generally accepted accounting principles in the United States.

Discrepancies in any table between the amounts identified as total amounts and the sum of the amounts listed therein are due to rounding.

This annual report contains translations of certain renminbi amounts into U.S. dollars at specified rates solely for the convenience of readers. All translations from renminbi to U.S. dollars were made at the noon buying rate in The City of New York for cable transfers in renminbi per U.S. dollar as certified for customs purposes by the Federal Reserve Bank of New York, or the noon buying rate. Unless otherwise stated, the translation of renminbi into U.S. dollars has been made at the noon buying rate in effect on December 31, 2017, which was RMB6.5063 to \$1.00. We make no representation that the renminbi or U.S. dollar amounts referred to in this annual report could have been or could be converted into U.S. dollars or renminbi, as the case may be, at any particular rate or at all. On May 4, 2018, the noon buying rate was RMB6.3589 to \$1.00.

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. Selected Financial Data

The following selected consolidated statements of comprehensive income (loss) data for the fiscal years ended December 31, 2017, 2016 and 2015, and consolidated balance sheet data as of December 31, 2017 and 2016 have been derived from our audited consolidated financial statements that are included in this annual report beginning on page F-1. The following selected consolidated statements of comprehensive income (loss) data for the fiscal years ended December 31, 2014 and 2013 and consolidated balance sheet data as of December 31, 2015, 2014 and 2013 have been derived from our audited consolidated financial statements that are not included in this annual report.

Our historical results do not necessarily indicate results expected for any future periods.

| Consolidated statements of Comprehensive income (loss) data | Year ended December 31, | | | | |
|---|--|---------------|---------------|---------------|-------------|
| | 2017 | 2016 | 2015 | 2014 | 2013 |
| | (in thousands except share and per share data) | | | | |
| Sales | \$ 174,346 | \$ 72,431 | \$ 67,414 | \$ 62,932 | \$ 71,774 |
| Cost of sales ⁽¹⁾ | 20,240 | 22,393 | 18,408 | 15,476 | 20,588 |
| Gross profit | 154,106 | 50,038 | 49,006 | 47,456 | 51,186 |
| Operating expenses: | | | | | |
| Selling, general and administrative expenses ⁽¹⁾ | 87,365 | 41,980 | 37,481 | 34,338 | 34,114 |
| Provision (recovery) for doubtful accounts | 934 | 1,412 | (49) | 329 | (504) |
| Research and development expenses ⁽¹⁾ | 20,489 | 12,648 | 9,490 | 10,934 | 8,128 |
| Loss on disposal and impairment of property, plant and equipment | 42 | 478 | 26 | 74 | 31 |
| Government grants recognized in income | (141) | (6,984) | (1,637) | (104) | - |
| Total operating expenses | 108,689 | 49,534 | 45,311 | 45,571 | 41,769 |
| Operating income | 45,417 | 504 | 3,695 | 1,885 | 9,417 |
| Interest and financing expenses | (1,569) | (1,729) | (1,920) | (3,407) | (3,031) |
| Interest income | 1,183 | 731 | 1,155 | 2,684 | 2,167 |
| Other income (expenses) | 13 | 100 | (174) | 1,186 | 392 |
| Income (loss) before income taxes and non-controlling interests | 45,044 | (394) | 2,756 | 2,348 | 8,945 |
| Income tax benefit (expenses) | (8,339) | (2,664) | (2,985) | (2,069) | 2,325 |
| Income (loss) from continuing operations | 36,705 | (3,058) | (229) | 279 | 11,270 |
| Income (loss) from discontinued operations, net of tax - nil | - | 2,338 | (728) | (1,524) | (1,266) |
| Net income (loss) | 36,705 | (720) | (957) | (1,245) | 10,004 |
| Less: (income) loss attributable to non-controlling interests | (10,898) | 124 | (459) | (270) | (2,900) |
| Net income (loss) attributable to shareholders of Sinovac | 25,807 | (596) | (1,416) | (1,515) | 7,104 |
| Comprehensive income (loss) | 44,803 | (9,563) | (5,342) | (3,648) | 12,674 |
| Less: comprehensive (income) loss attributable to non-controlling interests | (12,089) | 953 | 82 | 35 | (3,218) |
| Comprehensive income (loss) attributable to shareholders of Sinovac | 32,714 | \$ (8,610) | \$ (5,260) | \$ (3,613) | \$ 9,456 |
| Weighted average number of common shares outstanding | | | | | |
| - basic | 57,033,816 | 56,949,083 | 56,313,927 | 55,681,076 | 55,301,276 |
| - diluted | 57,101,191 | 56,949,083 | 56,313,927 | 56,114,202 | 55,802,338 |
| Earnings (loss) per share | | | | | |
| Basic net income (loss) per share: | | | | | |
| Continuing operations | 0.45 | (0.05) | (0.02) | 0.00 | 0.15 |
| Discontinued operations | - | 0.04 | (0.01) | (0.03) | (0.02) |
| Basic net income (loss) per share | <u>0.45</u> | <u>(0.01)</u> | <u>(0.03)</u> | <u>(0.03)</u> | <u>0.13</u> |
| Diluted net income (loss) per share: | | | | | |
| Continuing operations | 0.45 | (0.05) | (0.02) | 0.00 | 0.15 |
| Discontinued operations | - | 0.04 | (0.01) | (0.03) | (0.02) |
| Diluted net income (loss) per share | <u>0.45</u> | <u>(0.01)</u> | <u>(0.03)</u> | <u>(0.03)</u> | <u>0.13</u> |
| Weighted average number of shares of common stock outstanding | | | | | |
| - Basic | 57,033,816 | 56,949,083 | 56,313,927 | 55,681,076 | 55,301,276 |
| - Diluted | 57,101,191 | 56,949,083 | 56,313,927 | 56,114,202 | 55,802,338 |
| Supplemental information⁽²⁾ | | | | | |
| Non-GAAP EBITDA | 51,277 | 8,223 | 11,166 | 10,276 | 16,151 |
| Non-GAAP net income (loss) from continuing operations | 36,361 | 293 | 1,588 | 1,283 | 10,901 |
| Non-GAAP diluted EPS from continuing operations | \$ 0.44 | \$ 0.01 | \$ 0.01 | \$ 0.02 | \$ 0.14 |

(1) Includes share-based compensation of \$1.0 million, \$2.4 million, \$1.0 million, \$0.3 million, and \$0.3 million in 2017, 2016, 2015, 2014 and 2013, respectively.

(2) See "Non-GAAP Measures" below.

Non-GAAP Measures

We use non-GAAP EBITDA, non-GAAP net income from continuing operations and non-GAAP diluted EPS from continuing operations, in evaluating our operating results and for financial and operational decision-making purposes.

We believe that non-GAAP EBITDA, non-GAAP net income from continuing operations and non-GAAP diluted EPS from continuing operations help identify underlying trends in our business that could otherwise be distorted by the effect of certain income or expenses that we include in income from operations from continuing operations, net income from continuing operations and diluted EPS from continuing operations. We believe that non-GAAP EBITDA, non-GAAP net income from continuing operations and non-GAAP diluted EPS from continuing operations provide useful information about our core operating results, enhance the overall understanding of our past performance and future prospects and allow for greater visibility with respect to key metrics used by management in our financial and operational decision-making.

Non-GAAP EBITDA, non-GAAP net income from continuing operations and non-GAAP diluted EPS from continuing operations should not be considered in isolation or construed as an alternative to income from operations from continuing operations, net income from continuing operations, diluted EPS from continuing operations, or any other measure of performance or as an indicator of our operating performance. These non-GAAP financial measures presented here may not be comparable to similarly titled measures presented by other companies. Other companies may calculate similarly titled measures differently, limiting their usefulness as comparative measures to our data.

Non-GAAP EBITDA represents income (loss) from continuing operations, excludes interest and financing expenses, interest income, net other income (expenses) and income tax benefit (expenses), and certain non-cash expenses, consisting of share-based compensation expenses, amortization and depreciation that we do not believe are reflective of our core operating performance during the periods presented.

Non-GAAP net income from continuing operations represents net income from continuing operations before share-based compensation expenses, and foreign exchange gain or loss.

Non-GAAP diluted EPS from continuing operations represents non-GAAP net income attributable to ordinary shareholders from continuing operations divided by the weighted average number of shares outstanding during the periods on a diluted basis, including accounting for the effect of the assumed conversion of options.

The table below sets forth a reconciliation of our income (loss) from continuing operations to non-GAAP EBITDA for the periods indicated:

| | Year ended December 31, | | | | |
|---|-------------------------|------------|-----------|-----------|-----------|
| | 2017 | 2016 | 2015 | 2014 | 2013 |
| | (in thousands) | | | | |
| Income (loss) from continuing operations | \$ 36,705 | \$ (3,058) | \$ (229) | \$ 279 | \$ 11,270 |
| Adjustments: | | | | | |
| Share-based compensation | 979 | 2,409 | 952 | 287 | 281 |
| Depreciation and amortization | 4,881 | 5,310 | 6,519 | 8,104 | 6,453 |
| Interest and financing expenses, net of interest income | 386 | 998 | 765 | 723 | 864 |
| Net other (income) expense | (13) | (100) | 174 | (1,186) | (392) |
| Income tax (benefit) expense | 8,339 | 2,664 | 2,985 | 2,069 | (2,325) |
| Non-GAAP EBITDA | \$ 51,277 | \$ 8,223 | \$ 11,166 | \$ 10,276 | \$ 16,151 |

The following table sets forth a reconciliation of our net income from continuing operations to non-GAAP net income from continuing operations for the periods indicated:

| | Year ended December 31, | | | | |
|---|-------------------------|------------|----------|----------|-----------|
| | 2017 | 2016 | 2015 | 2014 | 2013 |
| | (in thousands) | | | | |
| Income (loss) from continuing operations | \$ 36,705 | \$ (3,058) | \$ (229) | \$ 279 | \$ 11,270 |
| Add: Foreign exchange loss (gain) | (1,323) | 942 | 865 | 717 | (650) |
| Add: Share-based compensation | 979 | 2,409 | 952 | 287 | 281 |
| Non-GAAP net income from continuing operations | \$ 36,361 | \$ 293 | \$ 1,588 | \$ 1,283 | \$ 10,901 |

The following table sets forth a reconciliation of our diluted EPS from continuing operations to non-GAAP diluted EPS from continuing operations for the periods indicated:

| | Year ended December 31, | | | | |
|--|--|------------|------------|------------|------------|
| | 2017 | 2016 | 2015 | 2014 | 2013 |
| | (in thousands except share and per share data) | | | | |
| Net income (loss) from continuing operations attributable to shareholders of Sinovac | \$ 25,807 | \$ (2,934) | \$ (688) | \$ 9 | \$ 8,370 |
| Add: Non-GAAP adjustments to net income from continuing operations ⁽¹⁾ | (344) | 3,351 | 1,817 | 1,004 | (369) |
| Non-GAAP net income (loss) attributable to shareholders of Sinovac from continuing operations for computing non-GAAP diluted earnings per share | 25,463 | 417 | 1,129 | 1,013 | 8,001 |
| Weighted average number of shares on a diluted basis | 57,101,191 | 56,949,083 | 56,313,927 | 56,114,202 | 55,802,338 |
| Diluted earnings (loss) per share from continuing operations⁽²⁾ | 0.45 | (0.05) | (0.02) | 0.00 | 0.15 |
| Add: Non-GAAP adjustments to net income per share from continuing operations ⁽³⁾ | (0.01) | 0.06 | 0.03 | 0.02 | (0.01) |
| Non-GAAP diluted earnings per share from continuing operations⁽⁴⁾ | \$ 0.44 | \$ 0.01 | \$ 0.01 | \$ 0.02 | \$ 0.14 |

(1) See the table above about the reconciliation of net income from continuing operations to non-GAAP net income from continuing operations for more information on these non-GAAP adjustments.

(2) Diluted EPS from continuing operations is derived from net income attributable to ordinary shareholders from continuing operations for computing diluted EPS divided by weighted average number of shares on a diluted basis.

(3) Non-GAAP adjustments to net income per share from continuing operations is derived from non-GAAP adjustments to net income from continuing operations divided by weighted average number of shares on a diluted basis.

(4) Non-GAAP diluted EPS from continuing operations is derived from non-GAAP net income attributable to ordinary shareholders from continuing operations for computing non-GAAP diluted EPS from continuing operations divided by weighted average number of shares on a diluted basis.

| Balance sheet data | As of December 31, | | | | |
|---|--------------------|------------|------------|------------|------------|
| | 2017 | 2016 | 2015 | 2014 | 2013 |
| | (in thousands) | | | | |
| Cash and cash equivalents | \$ 114,415 | \$ 62,434 | \$ 63,834 | \$ 89,793 | \$ 106,517 |
| Total assets | 299,219 | 211,355 | 202,927 | 238,663 | 240,726 |
| Short-term bank loans and current portion of long-term debt | 18,152 | 31,279 | 21,775 | 47,375 | 16,217 |
| Total current liabilities | 92,543 | 66,264 | 58,138 | 79,870 | 48,650 |
| Long term debt (include due to related party) | 21,919 | 9,448 | 756 | 1,803 | 32,146 |
| Net assets | 177,140 | 129,666 | 136,505 | 140,145 | 142,943 |
| Non-controlling interests | 25,988 | 13,899 | 14,852 | 14,934 | 14,969 |
| Common stock | 57 | 57 | 57 | 56 | 56 |
| Total shareholders' equity | \$ 151,152 | \$ 115,767 | \$ 121,653 | \$ 125,211 | \$ 127,974 |

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

Risks Related to Our Company

Our business growth relies on our ability to react to infectious disease threats and to continually introduce new vaccine products into the commercial market. Our failure to effectively develop and commercialize new products could materially and adversely affect our business, financial condition, results of operations and prospects.

The biopharmaceutical market in general and the vaccine product market in particular are developing rapidly as a result of ongoing infectious disease threats and new trends in the related research and technology developments. Consequently, our success depends on our ability to react to disease and technology development trends and to identify, develop and commercialize in a timely and cost-effective manner effective vaccine products that meet evolving market needs.

Whether we are successful in developing and commercializing new products is determined by, among other things, our ability to:

- accurately assess disease and technology trends and market needs;
- maintain strong research and development capabilities;
- optimize our manufacturing and procurement processes to predict and control costs;
- manufacture and deliver products with good quality in a timely manner and in sufficient quantities;
- increase customer awareness and acceptance of our products;
- minimize the time and cost required to obtain required regulatory clearances and approvals;
- anticipate and compete effectively with other vaccine product developers, manufacturers and marketers;
- price our products competitively;
- comply with the guidelines of Good Manufacturing Practice, or GMP, and other related regulations; and

- thoroughly understand the frequently developing regulatory guidelines and regulations on vaccine products and comply with the regulations and guidelines accordingly.

Although we are profitable in 2017, we incurred a loss in 2016 as well as in the past years, and may incur losses again in the future.

Biopharmaceutical product development is a highly speculative undertaking and involves a substantial degree of risk. We have incurred substantial losses since our inception. Although we were profitable in 2013, we incurred a loss again in 2014, 2015 and 2016. In the past years, the loss was caused primarily by research and development expenses. None of the research and development expenses incurred were capitalized in our financial statements. We intend to continue to invest in research and development to sustain our long-term growth. We expect our research and development expenses to fluctuate depending on the progress we make on each project, with relatively more spending on clinical studies than preclinical studies. We expect that our spending on research and development will have a negative impact on our future net earnings. As a result, we may incur losses in the future, which will have an adverse impact on our working capital, total assets, shareholders' equity and cash flow.

We sell vaccines in China through Centers for Disease Control, or CDCs, which are PRC government agencies. This exposes us to risks relating to doing business with the government.

We sell our vaccines to CDCs, which exposes us to various risks relating to doing business with the government. For example, demand and ability to pay for our products may be affected by government budgetary cycles, shifting availability of public funds and changes in policy. Funding reductions, delays in payment or unilateral demands for changes to the terms of our contracts by our government customers could adversely impact our results of operations and financial condition, exacerbate the existing seasonality of our revenues and make it difficult for us to allocate resources or anticipate demand for our products. More importantly, we have little or no control over government procurement decisions, and government agencies that contract to purchase our products may reduce or cancel orders, or demand price adjustments or other changes to their contracts with us without our consent. Changes in the personnel of the PRC government agencies that purchase our products may result in changes or delays to or cancellations of purchase commitments due to, among others, differing policy and budgetary agendas of the personnel involved. Similar changes could occur if CDC or other relevant government agency were to be consolidated with another ministry. Any of the above mentioned actions taken by government agencies could have a material adverse effect on our results of operations and expected earnings, or result in our failure to meet, or having to adjust downwards, our sales and gross margin guidance or estimates, which could adversely affect our stock price and result in substantial losses to you. In addition, many of the remedies that are available to us when dealing with private parties, such as making claims for breach of contract or taking other legal actions, may not be available or practicable in our dealings with government agencies.

We currently have limited revenue sources. A reduction in revenues from sales of Inlive, Healive, Bilive or Anflu would cause our revenues to decline and could materially harm our business.

We generate all of our revenues from sales of our vaccine products. We derive a substantial percentage of our revenues from a small number of vaccine products. Inlive (enterovirus 71, or EV71, vaccine) contributed 69.6% and 48.5% of our revenue in 2017 and 2016, respectively. In 2017, 2016 and 2015, 15.7%, 27.7% and 39.8%, respectively, of our revenues were from sales of Healive; 6.0%, 0.8% and 33.5%, respectively, of our revenues were from sales of Bilive; 7.8%, 13.6% and 18.8%, respectively, of our revenues were from sales of Anflu; and nil, 8.8% and 5.7%, respectively, of our revenues were from sales of Panflu (H5N1). However, revenue recognition of Panflu (H5N1) is not recurring due to its government stockpile nature, which may cause fluctuation of our revenue. As a result of this relative lack of product diversification, an investment in our company would be riskier than investments in companies that offer a wide variety of products or services.

We expect our key products, which will likely shift over time, to account for a significant portion of our net revenues for the foreseeable future. As a result, continued market acceptance and popularity of these products are critical to our success and a reduction in demand due to, among other factors, the introduction of competing products by our competitors, the entry of new competitors, or end-users' dissatisfaction with the quality of our products, could materially and adversely affect our financial condition and results of operations.

We could be subject to costly and time-consuming product liability actions and, because our insurance coverage is limited, our exposure to such claims could cause significant financial burden.

Our business exposes us to potential product liability risks that are inherent in the testing, manufacturing and marketing of biopharmaceutical products. We manufacture vaccines that are injected into healthy people to protect against infectious illnesses. If our products do not function as anticipated, whether as a result of flaws in our design, unanticipated health consequences or side effects, misuse or mishandling by third parties, or faulty or contaminated supplies, they could harm the vaccines and, as a result, subject us to product liability lawsuits. Claims against us also could be based on failure to immunize as anticipated. Any product liability claim brought against us, with or without merit, could have a material adverse effect on us. Meritless and unsuccessful product liability claims can be time-consuming and expensive to defend and could result in the diversion of management's attention from managing our core business or result in associated negative publicity.

Successful assertion of product liability claims against us could require us to pay significant monetary damages. Although we currently carry worldwide product liability insurance for Healive, Bilive, Anflu, Panflu and Inlive worldwide, we cannot assure you that such coverage will be sufficient to cover any liabilities resulting from successful product liability claims. In such a case, we may be required to make substantial payments to cover any losses, damages or liabilities arising from product liability claims. For any amounts covered by insurance, foreign exchange or other regulatory restrictions may prevent the use of insurance proceeds to meet the liabilities. In addition, we do not have or plan to procure clinical trial liability insurance for our clinical trials to mitigate any unsuccessful clinical trial expenses or product liability claims arising therefrom. Any of these factors could have a material adverse effect on our business, financial condition and results of operations.

Any pandemic threat may abate, or alternative vaccines or technologies may be adopted, before our vaccines achieve significant sales.

We have devoted significant resources to research and develop various vaccines to address the pandemic threat of infectious diseases, including SARS, avian flu and swine flu, and will continue to devote resources to the development of our vaccines to address any new needs.

However, the threat of a pandemic outbreak may subside before we realize any return on our investment in our research and development. For example, although we believe we were the first company to complete a phase I clinical trial of an inactivated SARS vaccine in December 2004, we did not proceed with the phase II and phase III trials as the SARS epidemic subsequently subsided. Other organizations may obtain licenses for their own pandemic vaccines, or government health organizations may acquire adequate stockpiles of pandemic vaccine or adopt other technologies or strategies to prevent or limit outbreaks before our pandemic vaccines achieve significant sales. We may not achieve a return on our investment before the threat of a pandemic outbreak subsides or a competing product is adopted.

Failure to comply with the U.S. Foreign Corrupt Practices Act, or the FCPA, and other applicable anti-corruption laws could subject us to penalties and other adverse consequences and corrupt practices by our competitors may place us at a competitive disadvantage.

Our executive officers, employees and other agents may violate applicable laws in connection with the marketing or sale of our products, including the FCPA and applicable anti-corruption laws in China and other jurisdictions in which our products are sold or registered for sale. The FCPA generally prohibits United States issuers from engaging in bribery or other prohibited payments to foreign officials for the purpose of obtaining or retaining business and requires issuers to maintain reasonable internal controls. The PRC also strictly prohibits bribery of government officials. We have adopted a policy regarding compliance with the FCPA and other applicable anti-corruption laws to prevent, detect and correct such corrupt practice. However, corruption, extortion, bribery, pay-offs, theft and other fraudulent practices occur from time to time in the PRC and the countries in which we seek to do business. While we have sought to enhance measures and controls to ensure compliance with the FCPA and other applicable anti-corruption laws by individuals involved with our company, our existing compliance policies and procedures may be insufficient or may fail to prevent our employees or other agents from engaging in inappropriate conduct for which we might be held responsible. If our employees or other agents are found to have engaged in such practices, we could suffer severe penalties and other consequences that may have a material adverse effect on our business, financial condition and results of operations. In addition, our brand and reputation, our sales activities or the price of our common shares could be adversely affected if we become the target of any negative publicity as a result of actions taken by our employees or other agents.

As discussed under “Item 8. Financial Information — A. Consolidated Statements and Other Financial Information — Legal and Administrative Proceedings,” we have conducted an internal investigation regarding FCPA related matters and have informed NASDAQ, the SEC and DOJ regarding these matters. At this time, we are unable to predict, what, if any, action may be taken by NASDAQ, the SEC and/or DOJ or any penalties or remedial measures these agencies may seek. Any determination that our operations or activities are not in compliance with existing laws or regulations could result in the imposition of fines, civil and criminal penalties, disgorgement and equitable remedies, including disgorgement or injunctive relief. The imposition of any of these sanctions or remedial measures could have a material adverse effect on our business.

In addition, there may be corrupt practices in the healthcare industry in China and other countries in which we conduct business. For example, in order to secure agreements with CDCs or hospitals in China, our competitors may engage in corrupt practices in order to influence decision-makers in violation of the anti-corruption laws of China and the FCPA. As competition persists and intensifies in our industry, we may lose potential clients, client referrals and other opportunities to the extent that our competitors engage in such practices or other illegal activities.

Failure to achieve and maintain effective internal controls could have a material adverse effect on our business, results of operations and the trading price of our common shares.

We are subject to the reporting obligations under U.S. securities laws. Section 404 of the Sarbanes-Oxley Act of 2002 and related rules require public companies to include a report of management on their internal control over financial reporting in their annual reports. This report must contain an assessment by management of the effectiveness of a public company’s internal control over financial reporting. In addition, an independent registered public accounting firm for a public company must attest to and report on the effectiveness of our internal control over financial reporting.

Our management has concluded that our internal control over financial reporting is effective as of December 31, 2017. See “Item 15. Controls and Procedures.” Our independent registered public accounting firm has issued an attestation report on our internal control over financial report, which concludes that our internal control over financial reporting is effective in all material aspects. However, we cannot assure you that any material weakness or deficiency in our internal control over financial reporting will not be identified in the future. We may not always be able to maintain an effective internal control over financial reporting. If we fail to maintain effective internal control over financial reporting in the future, we and our independent registered public accounting firm may not be able to conclude that we have effective internal control over financial reporting at a reasonable assurance level. This could in turn result in the loss of investor confidence in the reliability of our financial statements and negatively impact the trading price of our common shares, inhibiting our ability to raise sufficient capital on favorable terms. Furthermore, we have incurred and anticipate that we will continue to incur considerable costs and use significant management time and other resources in an effort to comply with Section 404 and other requirements of the Sarbanes-Oxley Act.

If we are unable to successfully compete in the highly competitive biopharmaceutical industry, our business could be harmed.

We operate in a highly competitive environment and we expect the competition to increase in the future. Our competitors include large pharmaceutical and biotechnology companies, both domestic and international. Many of these competitors have greater resources than we do. New competitors may also enter into the markets in which we compete. Accordingly, even if we are successful in launching a product, we may not be able to outperform a competing product for any number of reasons, including the possibility that the competitor may:

- have launched its competing product first or the competing product may have, or be perceived as having, better efficacy, stronger brand recognition, or other advantages;
- have better access to certain raw materials;
- have more efficient manufacturing processes and greater manufacturing capacity;
- have greater marketing capabilities;
- have greater pricing flexibility;

- have more extensive research and development and technical capabilities;
- have proprietary patent portfolios or other intellectual property rights that may present obstacles to our business;
- have greater knowledge of local market conditions where we seek to increase our international sales;
- have capability to maintain a competitive management team; or
- have investment capability to acquire businesses when the opportunity is not available to us.

The technologies applied by our competitors and us are rapidly evolving and new developments frequently result in price competition and product obsolescence. In addition, we may be impacted by competition from generic forms of our products, substitute products or imports of products from lower-priced markets. For a detailed description of our competitors in EV71 vaccine, hepatitis A vaccines, hepatitis A and B vaccines and influenza vaccines, please see “Item 4. Information on the Company — B. Business Overview — Competition.”

We may not be able to maintain market share in China with our commercialized vaccines, which could adversely affect our ability to increase our revenues.

We used to estimate our market share in China based on the batch release number published by the National Institutes for Food and Drug Control, or NIFDC, which represents the market share estimated based on published supply quantity, but not the actual number of sales in the market.

We started to market our EV71 vaccine in 2016. We supplied 18.8% and 52.5% of the EV71 vaccine market in China in 2017 and 2016, respectively.

We supplied 18.0%, 9.7% and 16.9% of the total hepatitis A vaccine market in China, or 75.8%, 76.3% and 89.8% of the inactivated hepatitis A vaccine market in China in 2017, 2016 and 2015, respectively, as measured by lot release number. We may not be able to compete with other hepatitis A suppliers for either the private-pay market or public market, which could adversely affect our ability to increase our revenues from hepatitis A vaccine.

We have been marketing and selling seasonal flu vaccines since 2006. We supplied 12.7%, 9.9% and 10.9% of the seasonal flu vaccine market in China in 2017, 2016 and 2015, respectively. The flu vaccine market in China is highly competitive. Our revenue could be adversely impacted if we are not able to maintain our market share in this highly competitive market.

We may not be able to maintain market share in the government-funded hepatitis A vaccine market, or other government-funded vaccine markets, which could adversely affect our revenues, and if we do maintain or expand market share in these markets, we may need to sell our vaccines at a lower price, which could adversely affect our gross margin.

Hepatitis A vaccines have been included in the Expanded Program on Immunization, or EPI, in China since 2007. The PRC government purchases hepatitis A vaccines for each 18-month-old child.

Although the hepatitis A vaccines have been included in the EPI, most provincial and municipal governments are not able to afford the two shots of inactivated hepatitis A vaccines due to insufficient financial support, which constrains the purchase of inactivated hepatitis A vaccines in government-funded markets. Most provincial and municipal governments prefer to purchase lower-priced live attenuated hepatitis A vaccines; however, a few affluent provincial and municipal governments, such as Beijing, Tianjin, Shanghai and Jiangsu province, have started to purchase inactivated hepatitis A vaccines. We are supplying vaccines in these markets at a lower price than we do in the private market, which could adversely affect our gross margin. Our revenue could be adversely impacted if we are not able to maintain our market share of the government-funded markets in these cities and provinces. As we are making efforts to breakthrough into additional provincial and municipal public markets, we may be forced to lower our prices to win tenders, which will adversely affect our gross margin.

Since 2007, we have been selected as one of the suppliers by Beijing CDC to supply seasonal influenza vaccines to Beijing citizens. We cannot assure you that we will continue to obtain orders in the future and maintain our market share. If the supply volume continues to decrease, it would negatively impact our sales revenue in the future.

Since 2008, we have received three stockpiling orders for our H5N1 vaccine from China's central government every two years in an amount of three million doses per order, and three stockpiling orders from Beijing government in an amount of 20,000 doses per order. The latest batch of stockpiled H5N1 vaccines for the central government has expired in the first half of 2016 and we recognized the revenue upon the government inspection. We cannot assure you that we will receive additional stockpiling orders from governments in the future.

If CDCs, hospitals, physicians and vaccinees do not accept our products, we may be unable to generate significant revenue.

Even if we have obtained regulatory approval for commercialization of our vaccines, they still may not gain market acceptance among CDCs, hospitals, physicians, vaccinees and the medical community, which would limit our ability to generate revenue and adversely affect our results of operations. CDCs, hospitals and physicians may not recommend products developed by us or our collaborators until clinical data or other factors demonstrate superior or comparable safety and efficacy of our products as compared to other available treatments. Even if the clinical safety and efficacy of our products are established, CDCs, hospitals and physicians may elect not to recommend these products for a variety of reasons. There are other vaccines and treatment options for the conditions that many of our products and product candidates target, such as EV71, hepatitis A and B and influenza. In order to successfully launch a product, we must educate physicians and vaccinees about the relative benefits of our products. If our products are not perceived as easy and convenient to use, perceived to present a greater risk of side effects or are not perceived to be as effective as other available treatments, CDCs, hospitals, physicians and vaccinees might not adopt our products. A failure of our products to gain commercial acceptance would have a material adverse effect on our business, financial condition and results of operations.

Our ongoing litigation seeking a determination whether the actions of certain shareholders constitute a trigger event under our shareholder rights plan, or our Rights Plan, could have a material adverse effect on the results of our operations and our financial condition.

On March 5, 2018, our company filed a lawsuit in the Court of Chancery of the State of Delaware seeking a determination whether certain of our shareholders, including 1Globe Capital LLC, or 1Globe, The Chiang Li Family, OrbiMed Advisors LLC and OrbiMed Capital LLC, or OrbiMed, and certain additional shareholders (collectively, the "Shareholder Group") had triggered our Rights Plan, by forming a group holding approximately 45% of outstanding shares, in excess of the plan's threshold of 15%, and acting in concert prior to our 2017 annual general meeting of shareholders, or the 2017 AGM. Our Rights Plan is intended to promote the fair and equal treatment of all Sinovac shareholders and ensure that no person or group can gain control of Sinovac through undisclosed voting arrangements, open market accumulation or other tactics potentially disadvantaging the interest of all our shareholders.

On April 12, 2018, 1Globe filed an amended answer to our complaint, counterclaims, and a third-party complaint against Mr. Weidong Yin alleging, among other allegations, that our Rights Plan is not valid, that Mr. Weidong Yin and the Buyer Consortium (described below), had previously triggered our Rights Plan, and that 1Globe did not trigger our Rights Plan. We, and our board of directors, believe that the actions taken by the board of directors were appropriate under the circumstances and in the interest of all our shareholders. We also believe that the allegations of the counterclaim and third-party complaint are without merit. 1Globe asks for various measures of equitable relief and also includes a claim for its costs, including attorneys' fees.

The litigation is currently in the pre-trial phase with a decision expected before the end of 2018, subject to appeal.

The Company cannot predict the outcome of the litigation, including whether our Rights Plan has been triggered and, if it has been, how the terms of our Rights Plan will be implemented. The Company also cannot predict how the litigation may affect our stock price, which could be volatile during the pendency of the suit and following its conclusion. Preparing for this litigation, or any related litigation or related matters, has caused the Company to incur significant costs and we expect these costs to continue until the litigation concludes. In addition, preparing for this litigation is time-consuming and may disrupt our operations and divert the attention of management and our employees from executing our strategic plan.

Our ongoing litigation against 1Globe and The Chiang Li Family claiming violations of U.S. federal securities laws could have a material adverse effect on the results of our operations and our financial condition.

On March 5, 2018, our company filed a lawsuit in the United States District Court for Massachusetts alleging violations of Section 13(d) and Section 13(g) of the Securities Exchange Act of 1934, or the Exchange Act, by 1Globe and The Chiang Li Family. The lawsuit alleges, among other things, that the defendant shareholders failed to make required disclosures on Schedule 13D regarding their intentions to attempt to replace our company's board of directors.

The litigation is currently in the pre-trial phase and the Company cannot predict when or how the litigation will be resolved. There can be no assurance that our company will prevail in this litigation. Preparing for this litigation, or any related litigation or related matters may result in significant costs to our company or otherwise adversely affect our business.

Our business could be negatively affected as a result of actions of shareholders or others.

On March 5, 2018, we announced the re-election of the members of our board of directors—Mr. Weidong Yin, Mr. Yuk Lam Lo, Mr. Simon Anderson, Mr. Kenneth Lee, and Mr. Meng Mei—at the 2017 AGM held on February 6, 2018. We also announced that we had determined, after consultation with our Antigua legal counsel, that an alternative, pre-printed ballot not made available to all our shareholders and purportedly submitted at our 2017 AGM by the Shareholder Group was invalid. We refer to this ballot as the “Non-Public Submission.”

On March 13, 2018, 1Globe filed a complaint against our company in the Eastern Caribbean Supreme Court in the High Court of Justice, Antigua and Barbuda, or the Antigua Court. The complaint seeks a declaration that the five persons purportedly proposed by the Shareholder Group on the Non-Public Submission at the 2017 AGM were elected as directors of our company at that meeting, an order of the Antigua Court that those directors be installed as our company's board of directors, and a declaration that any actions taken on behalf of our company at the direction of the board of directors since the 2017 AGM are null and void. On April 10, 2018, 1Globe filed a notice of application in the Antigua Court seeking an order declaring the result of the disputed election, an urgent order restraining our board of directors from acting, pending determination of the dispute, including acting to initiate or continue litigation against the Shareholder Group, and other related relief. Hearings in this litigation are scheduled for May 9 and May 18, 2018.

The Company cannot predict the outcome of the litigation, including whether the Company will prevail. The Company also cannot predict how the litigation may affect our stock price, which could be volatile during the pendency of the suit and following its conclusion. Preparing for this litigation, or any related litigation or related matters, has caused the Company to incur significant costs and we expect these costs to continue until the litigation concludes. In addition, preparing for this litigation is time-consuming and may disrupt our operations and divert the attention of management and our employees from executing our strategic plan. In addition, the uncertainties as to the composition of our board of directors, may materially and adversely affect business in unpredictable ways, which, in turn, could cause our revenue, earnings and operating cash flows to be materially and adversely affected.

Disruptive actions taken by the minority shareholder of Sinovac Biotech Co., Ltd., or Sinovac Beijing, caused suspension of production, destruction of products and disruption of our website, which may materially and adversely affect our business, financial condition and results of operations.

Sinovac Beijing, our principal operating subsidiary, is a Sino-foreign equity joint venture in which we own a 73.09% interest and Sinobioway Bio-medicine Co., Ltd. (formerly named Xiamen Bioway Group Co., Ltd), or Sinobioway Medicine, owns a 26.91% interest. Recent events suggest that Sinobioway Medicine's interests are not aligned with our interests. We cannot assure you that Sinobioway Medicine will be cooperative with us in handling matters related to the operations of Sinovac Beijing.

As the minority shareholder of Sinovac Beijing, according to Sinovac Beijing's articles of association, Sinobioway Medicine has the right to assign a director to the five-director board of Sinovac Beijing. Mr. Aihua Pan, the Chairman of the board of Sinovac Beijing, is the current representative of Sinobioway Medicine on the board of Sinovac Beijing. Accordingly, the representative of Sinobioway Medicine has the ability to take actions that bind Sinovac Beijing or to block any action that requires unanimous board approval. In addition, if we wish to transfer our equity interest in Sinovac Beijing, in whole or in part, to a third party, Sinobioway Medicine has a right of first refusal to purchase our interest in accordance with relevant PRC regulations.

Sinobioway Medicine, the minority shareholder of Sinovac Beijing, has additional rights under the joint venture contract and articles of association of Sinovac Beijing. The joint venture contract and articles of association require the consent of each of Sinovac Beijing's shareholders and/or unanimous board approval on matters such as a major change in the business line of the company, expansion or amendment of the business scope of the company, transfer of the registered capital by a shareholder, creation of a mortgage or pledge upon the company's assets, a change in the organizational form of the company and designation or removal of the general manager.

In February 2018, Mr. Pan, the representative of Sinobioway Medicine, sent letters without the approval of the full board of Sinovac Beijing, to Mr. Weidong Yin, Ms. Nan Wang, and other senior managers of Sinovac Beijing purporting to terminate their employment. The board of directors of Sinovac Beijing subsequently determined, with the advice of PRC legal counsel, that this action did not conform with the joint venture contract and articles of association and was unlawful. On March 5, 2018, Sinovac Biotech announced actions taken to enhance the corporate governance and management of Sinovac Beijing, including the appointment of Mr. Dawei Mao, Chairman of Zhongke Biopharmaceutical Co., Ltd., as a director of Sinovac Beijing. He replaced Ms. Xiaomin Yang, the current President of Sinobioway Group Co., Ltd. In addition, in March 2018, Mr. Weidong Yin, Ms. Nan Wang, and other senior managers of Sinovac Beijing signed new employment agreements with Sinovac Biotech Ltd. and Sinovac Beijing.

On April 17, 2018, Mr. Pan and dozens of unidentified individuals forcibly entered Sinovac Beijing's corporate offices and limited the physical movements of employees in Sinovac Beijing's general manager's office and finance department in an attempt to wrongfully take control of Sinovac Beijing's official seal, legal documents, accounting seal, financial documents and financial information systems. In addition, these individuals disrupted Sinovac Beijing's hepatitis A vaccine production and seasonal flu vaccine production by cutting power, seriously impacting Sinovac Beijing's production and manufacturing processes and possibly damaging product quality. Due to the actions of the representative of Sinobioway Medicine, Sinovac Beijing was forced to destroy the affected products. To maintain product safety, Sinovac Beijing temporarily suspended production at the impacted facility and will continue to take every action to eliminate any biological safety risks due to the power outage. Sinovac Beijing was also forced to destroy the bacterial seeds intended for use in the production of its 23-valent pneumococcal polysaccharide vaccine, or PPV, and to suspend all preparations for and ultimately postpone the PRC State Food and Drug Administration, or CFDA, inspection of the manufacturing site necessary for 23-valent PPV production approval.

These and other actions taken by the representative of Sinobioway Medicine may materially and adversely affect our business, financial condition and results of operations. We also cannot assure you that the representative of Sinobioway Medicine will cease from interfering with our business.

We may not achieve the expected return on our investment in Sinovac (Dalian) Vaccine Technology Co., Ltd., or Sinovac Dalian.

In November 2009, we entered into an agreement with Dalian Jin Gang Group to establish Sinovac Dalian. In January 2010, we established Sinovac Dalian to focus on the research, development, manufacturing and commercialization of vaccines, such as mumps and varicella for human use. Pursuant to the joint venture agreement, we made an initial cash contribution of RMB60.0 million (\$9.3 million) in exchange for a 30% equity interest in Sinovac Dalian, and Dalian Jin Gang Group made an asset contribution of RMB140.0 million (\$21.6 million), including the manufacturing facilities, production lines and land use rights, in exchange for the remaining 70% interest in Sinovac Dalian. In December 2010, we purchased an additional 25% equity interest in Sinovac Dalian from Dalian Jin Gang Group for consideration of RMB50.0 million (\$7.7 million). In October 2016, we increased our ownership in Sinovac Dalian to 67.86% by making an additional RMB80.0 million (\$12.8 million) capital contribution. We cannot assure you that Sinovac Dalian's business, covering the research, development, manufacturing and commercialization of vaccines, such as mumps and varicella, will be successful. As such, we could incur related impairment charges in the future. Any failure to achieve the expected return on our investment in Sinovac Dalian may materially and adversely affect our business, financial condition and results of operations.

The interests of the minority shareholder of Sinovac Beijing and Sinovac Dalian may diverge from our own, which may adversely affect our ability to manage these subsidiaries.

Under China's joint venture regulations, the unanimous approval of members of a joint venture's board of directors who are present at a board meeting is required for any amendment to the joint venture's articles of association, the termination or dissolution of the joint venture company, an increase or decrease in the registered capital of the joint venture company or a merger or de-merger of the joint venture. If our interests diverge from those of our minority shareholders, they may exercise their rights under PRC laws to protect their own interests, which may be adverse to ours. As a result, our ability to manage these subsidiaries may be adversely affected, which in turn may materially and adversely affect our business, financial condition and results of operations. Recent disruptive actions taken by Sinobioway Medicine suggest that its interests are not aligned with our interests. We cannot assure you that Sinobioway Medicine will be cooperative with us in handling matters related to the operations of Sinovac Beijing. To date, Dalian Jin Gang Group has been cooperative with us in handling matters with respect to the business of Sinovac Dalian. We cannot assure you, however, that Dalian Jin Gang Group will continue to act in a cooperative manner in the future.

Our growth may be adversely affected if market demand for our vaccine products and product candidates does not meet our expectations. We may encounter problems of inadequate supply or oversupply, which would materially and adversely affect our financial condition and results of operations and would also damage our reputation and brand.

The production of vaccine products is a lengthy and complex process. As a result, our inability to match our production to market demand may result in a failure to meet market demand, which could materially and adversely affect our financial condition and results of operations and could also damage our reputation and corporate brand. For example, many vaccinees receive their seasonal flu vaccinations in the three-month period from September to November in anticipation of an upcoming flu season and we expect this period to be one of the most significant sales periods for this product each year. In anticipation of the flu season, we intend to build up inventory of our Anflu product in line with what we believe will be the anticipated demand for the product. If actual demand does not meet our expectations, we may be required to write off significant inventory and may otherwise experience adverse consequences in our financial condition. If we overestimate demand, we may purchase more raw materials than required. If we underestimate demand, our third-party suppliers may have inadequate raw material inventories, which could interrupt our manufacturing, delay shipments and result in lost sales.

If we are unable to enroll sufficient vaccinees and identify clinical investigators for our clinical trials, our development programs could be delayed or terminated.

The rate of completion of our clinical trials significantly depends on the rate of enrollment of volunteers. Vaccinees enrollment is a function of many factors, including:

- efforts of the sponsor and clinical sites involved to facilitate timely enrollment;
- vaccinee referral practices of physicians;
- design of the protocol;
- eligibility criteria for the study in question;
- perceived risks and benefits of the drug under study;
- the size of the vaccinee population;
- availability of competing therapies;
- availability of clinical trial sites; and
- proximity of and access by vaccinees to clinical sites.

We may have difficulty in obtaining sufficient volunteer subjects enrollment or finding qualified investigators to conduct our clinical trials as planned and we may need to expend substantial funds to obtain access to resources or delay or modify our plans significantly. These considerations may lead us to consider the termination of development of a product for a particular indication.

A setback in any of our clinical trials could adversely affect our share price.

Clinical trials are an important part of vaccine research before any vaccine is approved for commercial use in humans. Setbacks in any phase of the clinical trials of our product candidates could have a material adverse effect on our business and our prospects and financial results and would likely cause a decline in the price of our common shares. We may not achieve our projected development goals in the time frames we announce and expect. If we fail to achieve one or more milestones as contemplated, the market price of our common shares could decline.

We set goals for and make public statements regarding our anticipated timing of the accomplishment of objectives material to our success, such as the commencement and completion of clinical trials and other milestones. The actual timing of these events can vary significantly due to factors such as delays or failures in our clinical trials, the uncertainties inherent in the regulatory approval process and delays in achieving manufacturing or marketing arrangements sufficient to commercialize our products. We may not complete our clinical trials or make regulatory submissions or receive regulatory approvals as planned. Also, we may not be able to adhere to our anticipated schedule for the launch of any of our products. If we fail to achieve one or more milestones as contemplated, the market price of our shares could decline. We obtained the approval to conduct clinical trials for our Sabin inactivated polio vaccine, or sIPV, in December 2015 and phase I and II trials were completed in April 2017. The phase III trial was commenced in August 2017 and is expected to be completed in the second quarter of 2018.

We rely on third parties to conduct clinical trials, who may not perform their duties satisfactorily.

After we obtain approval to conduct clinical trials for our product candidates, we rely on qualified research organizations, medical institutions and clinical investigators to enroll qualified vaccinees and conduct clinical trials. Our reliance on these third parties for clinical development activities reduces our control over the clinical trial process. Furthermore, these third parties may also have relationships with other entities, some of which may be our competitors. If these third parties do not fulfill their contractual obligations, including failing to meet expected deadlines, we may not succeed or may experience delays in our efforts to obtain regulatory approvals and commercialize our vaccine candidates.

If any of our third-party suppliers or manufacturers cannot adequately meet our needs, our business could be harmed.

While we use raw materials and other key material supplies that are generally available from multiple commercial sources, certain raw materials that we use to cultivate our influenza vaccines, such as embryonated eggs, are in short supply or difficult for suppliers to produce in accordance with our specifications. If third-party suppliers were to cease production or otherwise fail to supply us with quality raw materials, and if we were unable to contract on acceptable terms for these materials with alternative suppliers, our ability to deliver our products to the market would be adversely affected.

In addition, if we fail to secure long-term supply sources for some of the raw materials we use, our business could be harmed. For example, we do not have a long-term agreement for the supply of hepatitis B antigens used for Bilive production. We source hepatitis B antigens entirely from Beijing Tiantan Biological Products Co., Ltd., or Beijing Tiantan. Although we are developing our own hepatitis B vaccine, before it is approved to be commercialized, we have to rely on the supplier to receive hepatitis B antigen. We and Beijing Tiantan agreed to enter into annual hepatitis B antigens supply agreements after our previous ten-year exclusive supply framework agreement expired in October 2012. Beijing Tiantan supplied hepatitis B antigens to us from July 2013 to June 2015 based on the annual supply agreement. Thereafter, Beijing Tiantan ceased its hepatitis B antigens production due to facilities renovation until 2018. To ensure sufficient storage, we procured an abundant amount of hepatitis B antigens from Beijing Tiantan and produced a significant amount of Bilive in 2015. Beijing Tiantan could delay its renovation schedule and cease to supply us with hepatitis B antigens in the future, in which case our business, financial condition and results of operations may be materially and adversely affected.

From time to time, concerns are raised with respect to potential contamination of biological materials supplied to us. These concerns can tighten market conditions for materials that may be in short supply or available from limited sources. Moreover, regulatory approvals to market our products may be conditioned upon obtaining certain materials from specified sources. Any efforts to substitute material from an alternate source may be delayed by pending regulatory approval of such alternate source. Although we work to mitigate the risks associated with relying on sole suppliers, material shortages could impact product development and production.

Our business is highly seasonal. This seasonality will contribute to our operating results fluctuating considerably throughout the year.

The seasonality in our business is expected to result in significant quarterly fluctuations in our ongoing operating results. For example, the influenza season generally runs from November through March of the next year and the largest percentage of influenza vaccinations is administered between September and November of each year. As a result, we expect to realize most of our annual revenues from Anflu during this period.

We rely on a limited number of facilities for the manufacturing of our products in accordance with relevant regulatory requirements. Any disruption to our existing manufacturing facilities or in the development of new facilities could reduce or restrict our sales and harm our reputation.

According to the China GMP guidelines, each vaccine product can only be produced in a dedicated production facility. In Beijing, we conduct the primary production of each vaccine in a dedicated production plant at our Shangdi site or Changping site, and secondary filling and packaging at our Changping site. In Dalian, we manufacture mumps vaccine at one facility. We do not maintain back-up facilities for our currently available products, so we are dependent on our existing facilities for the continued operation of our business.

As described more fully above, a representative of Sinobioway Medicine, who is the Chairman of the board of directors of Sinovac Beijing, and dozens of unidentified individuals forcibly entered Sinovac Beijing's corporate offices and disrupted Sinovac Beijing's hepatitis A vaccine production and seasonal flu vaccine production by cutting power to our Shangdi site, seriously impacting Sinovac Beijing's production and manufacturing processes and possibly damaging product quality. Due to the actions of the representative of Sinobioway Medicine, Sinovac Beijing was forced to destroy the affected products. To maintain product safety, Sinovac Beijing temporarily decided to stop production at the impacted facility and will continue to take every action to eliminate any biological safety risks due to the power outage.

Natural disasters or other unanticipated catastrophic events, including power interruptions, water shortages, storms, fires, earthquakes and terrorist attacks, could significantly impair our ability to manufacture our products and operate our business and could also delay our research and development activities. Our facilities and certain equipment located in these facilities would be difficult to replace and could require substantial replacement lead-time. Catastrophic events may also destroy any inventory located in our facilities.

We do not maintain any business interruption insurance to cover lost income as a result of any such events. The occurrence of such events could materially and adversely affect our business. We may build additional manufacturing facilities in the future. There can be no assurance, however, that we will be able to expand our manufacturing capabilities to or realize the anticipated benefits of our new facilities. Any of these factors could reduce or restrict our sales, harm our reputation and have a material adverse effect on our business, financial condition, results of operations and prospects.

We will need additional capital to upgrade the production plant for our existing products or expand the facility, to continue development of our product pipeline and to market existing and future products on a large scale. We cannot guarantee that we will find adequate sources of capital in the future.

We closed a public offering of our common shares on February 2, 2010, and received net proceeds of approximately \$61.8 million, after deducting underwriting discounts and commissions and offering expenses payable by us. We have invested approximately \$29.2 million in incorporation of Sinovac Dalian and invested \$26.8 million in Sinovac Research & Development Co., Ltd. or Sinovac R&D to conduct research and development and other operating activities of operational entities in PRC. We have used the remaining net proceeds from the offering for the research and development of our product candidates and other general corporate purposes.

In the long run, we will need to raise additional funds to finance equipment expenditures, to acquire intellectual property, to expand the production facility for our pipeline products, to continue the development and commercialization of our product candidates and to fund other corporate purposes. As of December 31, 2017, we had approximately \$114.4 million in cash and cash equivalents. We expect to undertake significant future financings in order to:

- establish and expand manufacturing capabilities;
- proceed with the research and development of other vaccine products, including clinical trials of new products;
- commercialize our products, including the marketing and distribution of new and existing products;
- seek and obtain regulatory approvals;
- develop or acquire directly, or indirectly through acquisition of companies, other product candidates or technologies or companies;
- protect our intellectual property; and
- finance general, administrative and research activities that are not related to specific products under development.

In the past, we funded most of our research and development and other expenditures through government grants, working capital, bank loans and proceeds from private placements and public offerings of our common shares. We may raise additional funds in the future because our current operating and capital resources may be insufficient to meet future requirements.

If we raise additional funds by issuing equity securities, it will result in further dilution to our existing shareholders because the shares may be sold when the market price is low and shares issued in equity financing transactions will normally be sold at a discount to the current market price. Any additional equity securities issued also may provide for rights, preferences or privileges senior or otherwise preferential to those of holders of our existing common shares. Unforeseen problems including materially negative developments relating to, among other things, disease developments, product sales, new product rollouts, clinical trials, research and development programs, our strategic relationships, our intellectual property, litigation, regulatory changes in our industry, the Chinese market generally or general economic conditions, could interfere with our ability to raise additional funds or materially and adversely affect the terms upon which such funding is available.

If we raise additional funds by issuing debt securities, these debt securities would have rights, preferences and privileges senior to those of holders of our common shares, and the terms of the debt securities issued could impose significant restrictions on our operations. If we raise additional funds through collaborations and licensing arrangements, we might be required to relinquish significant rights to certain of our technologies, marketing territories, product candidates or products that we would otherwise seek to develop or commercialize ourselves, or be required to grant licenses on terms that are not favorable to us. In the past, we have received different types of grants from the PRC government to finance the research and development and facility investment of our vaccine products. We may not receive additional grants in the future.

As described above, the actions of the Shareholder Group leading up to and at our 2017 AGM resulted in uncertainties as to the future direction of our company and the composition of our board of directors. As a result of these uncertainties, we do not know whether additional financing will be available to us on commercially acceptable terms when needed. If adequate funds are not available or are not available on commercially acceptable terms, we may be unable to continue developing our products. In any such event, our ability to bring a product to market and obtain revenues could be delayed and competitors could develop products sooner than we do. As a result, our business, financial condition and results of operations could be materially and adversely affected.

If we are unable to attract, train, retain and motivate our direct sales force and third-party marketing agents, sales of our products may be materially and adversely affected.

We rely on our direct sales force and third-party marketing agents, who are dispersed across China, to market our products to CDCs and other healthcare institutions. We believe that our future success will depend on the dedication, efforts and performance of our direct sales force and third-party marketing agents. There are only limited numbers of competent and qualified marketing agents in the China vaccine industry. Our competitors may provide commissions or other economic incentives to third-party marketing agents significantly above the market standard, which may cause such agents to cease marketing our products. If we are unable to attract, train, retain and motivate our direct sales force and marketing agents, sales of our products may be materially and adversely affected.

Anti-corruption measures taken by the PRC government to correct corruptive practices in the vaccine industry could adversely affect our sales and reputation.

The PRC government has taken anti-corruption measures to correct corrupt practices. In the vaccine industry, such practices include, among others, acceptance of kickbacks, bribery or other illegal gains or benefits by the CDCs in connection with the prescription of a certain vaccine. We do not control our third-party marketing agents, who may engage in corrupt practices to promote our products. While we maintain strict anti-corruption policies applicable to our internal sales force and third-party marketing agents, these policies may not be completely effective. If our sales staff or any of our third-party marketing agents engage in such practices and the PRC government takes enforcement action, our products may be seized and our own practices, and involvement in the market agents' practices may be investigated. If this occurs, our sales and reputation may be materially and adversely affected.

Some of the predecessor shareholders of Sinovac Beijing were enterprises owning state-owned assets, or EOSAs. Their failures to comply with PRC legal requirements in asset or share transfers could, under certain circumstances, result in such transfers being invalidated by government authorities. If this occurs, we could lose our ownership of intellectual property rights that are vital to our business as well as our equity ownership in Sinovac Beijing.

Sinovac Beijing is currently owned 73.09% by us and 26.91% by Sinobioway Medicine (formerly named Xiamen Bioway Group Co., Ltd). The technologies related to our hepatitis A vaccine, hepatitis A and B vaccine and influenza vaccine that are vital to our business were directly or indirectly transferred to us by Tangshan Yian Biological Engineering Co., Ltd., or Tangshan Yian. Some of the predecessor shareholders of Sinovac Beijing, including Shenzhen Kexing Biological Engineering Ltd., or Shenzhen Kexing, Sinobioway Medicine, Tangshan Medicine Biotech Co., Ltd., Tangshan Yikang Biotech Co., Ltd. and Tangshan Yian, were EOSAs.

Under applicable PRC laws, when EOSAs sell, transfer or assign assets or equity investments in their possession or under their control to third parties, they are required to obtain an independent appraisal of the transferred assets or shares and file such appraisal with or obtain approval of such appraisal from PRC government authorities. Since 2004, EOSAs have also been required to make such assets or equity transfers at government-designated marketplaces. Certain of our acquisitions of intellectual property rights and some equity interests were subject to these requirements.

Tangshan Yian failed to file with the government authorities the appraisal of the hepatitis A vaccine technology that it transferred to Sinovac Beijing in 2001 as its capital contribution to Sinovac Beijing. Under PRC laws, Tangshan Yian also failed to:

- obtain the appraisal of the hepatitis A and B vaccine technology that it transferred for no consideration to Beijing Keding Investment Co., Ltd., or Beijing Keding, in 2002 (Beijing Keding subsequently transferred the technology to Sinovac Beijing as Beijing Keding's capital contribution to Sinovac Beijing) and to file such appraisal with the government authorities; and
- obtain the appraisal of the influenza vaccine technology that it transferred to Sinovac Beijing in 2004 and to file such appraisal with the government authorities.

These failures subject us to the risk of losing ownership or control of these vaccine technologies.

In addition, before we acquired our 73.09% equity interest in Sinovac Beijing, it had undergone multiple changes in its shareholders and the amounts held by the same. Some of the EOSA shareholders of Sinovac Beijing have sold, transferred or assigned their respective equity interests in Sinovac Beijing without fully complying with laws to appraise the equity interests, to file such appraisals with or obtain regulatory approval of such appraisals from PRC government authorities or to make equity interest transfers at the government-designated marketplaces as required for transactions completed after 2004. Similar to the asset transfers, such failures subject us to the risk of losing the ownership or control of our equity interest in Sinovac Beijing.

PRC government authorities may take court actions to invalidate the transfers of the assets or equity investments discussed above for non-compliance with applicable appraisal, filing, approval and designated marketplace requirements. The government authorities could take such legal actions and such legal actions, if commenced, could be successful. If these transfers are invalidated, we would lose title to these assets and investments. Because we depend on these technologies and because Sinovac Beijing constitutes core part of our operations, our loss of these technologies or equity interest in Sinovac Beijing would materially and adversely affect our operations and financial condition.

There can be no assurance that the going private transaction will be successfully consummated. Potential uncertainty involving the going private transaction may adversely affect our business and the market price of our common shares, and we are restricted from soliciting or, subject to certain exceptions, engaging in negotiations with third parties regarding competing proposals.

On June 26, 2017, we entered into a definitive amalgamation agreement, or the Amalgamation Agreement, with Sinovac (Cayman) Limited, or Parent, and Sinovac Amalgamation Sub Limited, or Amalgamation Sub, a wholly owned subsidiary of Parent. On March 26, 2018, we amended the Amalgamation Agreement to extend its termination date to April 26, 2018. On April 26, 2018, we further amended the Amalgamation Agreement to extend its termination date to May 26, 2018. Pursuant to the Amalgamation Agreement, Parent will acquire Sinovac Biotech Ltd. for cash consideration equal to \$7.00 per common share. Subject to the terms and conditions of the Amalgamation Agreement, at the effective time of the amalgamation, Amalgamation Sub will be amalgamated with and into Sinovac Biotech Ltd., with Sinovac Biotech Ltd. continuing as the surviving corporation and a wholly owned subsidiary of Parent, or the Amalgamation. Our board of directors, acting upon the unanimous recommendation of the special committee formed by the board of directors, or the Special Committee, unanimously approved the Amalgamation Agreement and the transactions contemplated by the Amalgamation Agreement, including the Amalgamation, and resolved to recommend that our shareholders authorize and approve the Amalgamation Agreement and the transactions contemplated by the Amalgamation Agreement, including the Amalgamation. Immediately following the consummation of the transaction contemplated by the Amalgamation Agreement, Parent would be beneficially owned by a consortium, or the Buyer Consortium, comprising Mr. Weidong Yin, our chairman, president and chief executive officer, SAIF partners IV L.P., or SAIF, C-Bridge Healthcare Fund II, L.P., Advantech Capital L.P., Vivo Capital Fund VIII, L.P. and Vivo Capital Surplus Fund VIII, L.P.

The Amalgamation is subject to customary closing conditions, including approval by an affirmative vote of holders of our common shares representing at least two-thirds of the shares present and voting in person or by proxy as a single class at a meeting of our shareholders, which will be convened to consider the authorization and approval of the Amalgamation Agreement and the transactions contemplated by the Amalgamation Agreement, including the Amalgamation, and the other closing conditions specified in the Amalgamation Agreement. If completed, the Amalgamation will result in Sinovac Biotech Ltd. becoming a privately-held company and our common shares will no longer be listed on NASDAQ. The going private transaction, whether or not consummated, presents a risk of diverting management focus, employee attention and resources from other strategic opportunities and from operational matters. Potential uncertainty involving the going private transaction may adversely affect our business and the market price of our common shares.

In addition, the Amalgamation Agreement restricts our ability, until the effective time of the Amalgamation or, if earlier, the extended termination of the Amalgamation Agreement, to solicit or, subject to certain exceptions, engage in discussions or negotiations with third parties regarding certain competing proposals or transactions as described in the Amalgamation Agreement, and if the Amalgamation Agreement is terminated under certain circumstances, we may be required to pay Parent a termination fee of \$15.0 million.

Our Rights Plan and certain provisions of our By-laws may discourage a change of control.

In March 2016, we adopted our Rights Plan that provides for the issuance of one right, or the Right, for each of our outstanding common shares. We amended our Rights Plan twice to extend its term for an additional 12-month period in March 2017 and again amended it to extend its term for an additional 12-month period in March 2018. The Rights are designed to assure that all of our shareholders receive fair and equal treatment in the event of any proposed takeover and to guard against partial tender offers, open market accumulations, undisclosed voting arrangements and other abusive or coercive tactics to gain control of our company or our board of directors without paying all shareholders a control premium. The Rights will cause substantial dilution to a person or group that acquires 15% or more of the common shares on terms not approved by our board of directors. In June 2017, we amended our Rights Plan in connection with the execution of the Amalgamation Agreement.

As described above, IGlobe seeks a determination by the Court of Chancery of the State of Delaware that our Rights Plan is invalid. If IGlobe is successful, our shareholders will not benefit from the protections of our Rights Plan and our company may be subject to abusive or coercive tactics by certain shareholders to gain control of our company or our board of directors without paying all shareholders a control premium.

Some provisions of our By-laws may discourage, delay or prevent a change in control of our company or management that shareholders may consider favorable, including provisions that authorize our board of directors to issue preferred shares in one or more series and to designate the price, rights, preferences, privileges and restrictions of such preferred shares without any further vote or action by our shareholders.

These provisions could make it more difficult for a third party to acquire us, even if the third party's offer may be considered beneficial by many shareholders. As a result, shareholders may be limited in their ability to obtain a premium for their shares.

We depend on our key personnel, the loss of whom would adversely affect our operations. If we fail to attract and retain the talent required for our business, our business will be materially harmed.

We are a small company with 644 full-time employees as of December 31, 2017 and we depend to a great extent on principal members of our management and scientific teams. If we lose the services of any key personnel, in particular Mr. Weidong Yin, the loss could significantly impede the key decision making on strategic choices and operational issues, which in turn will harm our business achievement. We do not have any key man life insurance policies. We have entered into employment agreements with our executive officers, under which they have agreed to restrictive covenants relating to non-competition and non-solicitation. These employment agreements do not, however, guarantee that we will be able to retain the services of our executive officers in the future.

As described above, a representative of Sinobioway Medicine, who is the Chairman of the board of directors of Sinovac Beijing, sent letters without the approval of the full board of Sinovac Beijing, to Mr. Weidong Yin, Ms. Nan Wang, and other senior managers of Sinovac Beijing purporting to terminate their employment. The board of directors of Sinovac Beijing subsequently determined, with the advice of PRC legal counsel, that this action did not conform with the joint venture contract and articles of association and was unlawful. As also described above, the representative of Sinobioway Medicine and dozens of unidentified individuals forcibly entered Sinovac Beijing's corporate offices and limited the physical movements of employees in Sinovac Beijing's general manager's office and finance department in an attempt to wrongfully take control of Sinovac Beijing's official seal, legal documents, accounting seal, financial documents and financial information systems. As a result of these actions, our ability to attract and retain the talent required for our business may be materially harmed.

In addition, recruiting and retaining additional qualified scientific, technical and managerial personnel and research partners will be critical to our success. Competition among biopharmaceutical and biotechnology companies for qualified employees in China is intense and turnover rates are high. There is a shortage of employees in China with expertise in our areas of research and clinical and regulatory affairs, and this shortage is likely to continue. We may not be able to retain existing personnel or attract and retain qualified staff in the future. If we fail to hire and retain personnel in key positions, we may be unable to develop or commercialize our product candidates in a timely manner.

We may encounter difficulties in managing our growth, which could adversely affect our results of operations.

We have experienced rapid and substantial growth and, if such growth continues, will place a strain on our administrative and operational infrastructure. We also plan to introduce new products to market that, if successful, could place a strain on our administrative and operational infrastructure. If we are unable to manage this growth effectively, our business, results of operations or financial condition may be materially and adversely affected. Our ability to manage our operations and growth effectively requires us to continue to improve our operational, financial and management controls, reporting systems and procedures and hiring programs. We may not be able to successfully implement these required improvements.

International expansion may be costly, time-consuming and difficult. If we do not successfully expand internationally, our growth strategy and prospects would be materially and adversely affected.

We have entered into selected international markets and intend to continue to expand the sales of our products into new international markets. In expanding our business internationally, we have entered, and intend to continue to enter, markets in which we have limited or no experience and in which our brand may be less recognized. To promote our brand and generate demand for our products to attract distributors in international markets, we expect to spend significantly more on marketing and promotion than we do in our existing domestic markets when appropriate. We may be unable to attract a sufficient number of distributors, and our selected distributors may not be suitable for selling our products.

In new markets, we may fail to anticipate competitive conditions that are different from those in our existing markets. These competitive conditions may make it difficult or impossible for us to effectively operate in these markets. If our expansion efforts in existing and new internal markets are unsuccessful, our growth strategy and prospects would be materially and adversely affected.

We are exposed to other risks associated with international operations, including:

- political instability;
- economic instability and recessions;
- changes in tariffs;
- difficulties of administering foreign operations generally;
- limited protection for intellectual property rights;
- obligations to comply with a wide variety of foreign laws and other regulatory approval requirements;
- increased risk of exposure to terrorist activities;
- financial condition, expertise and performance of our international distributors;
- export license requirements;
- unauthorized re-export of our products;
- potentially adverse tax consequences;
- inability to effectively enforce contractual or legal rights; and
- exchange rate fluctuations or devaluation of foreign currencies.

We may undertake acquisitions which may have a material adverse effect on our ability to manage our business and may end up being unsuccessful.

Our growth strategy may involve the acquisition of new production lines, technologies, businesses, products or services or the creation of strategic alliances in areas in which we do not currently operate. These acquisitions could require that our management develop expertise in new areas or new geographies, manage new business relationships and attract new types of customers. Furthermore, acquisitions may require significant attention from our management, and the diversion of our management's attention and resources could have a material adverse effect on our ability to manage our business. We may experience difficulties integrating acquisitions into our existing business and operations. Future acquisitions may also expose us to potential risks, including risks associated with:

- the integration of new operations, services and personnel;
- unforeseen or hidden liabilities;

- the diversion of resources from our existing businesses and technologies;
- our inability to generate sufficient revenue to offset the costs of acquisitions;
- potential loss of, or harm to, relationships with employees or customers, any of which could significantly disrupt our ability to manage our business and materially and adversely affect our business, financial condition and results of operations; and
- impairment of intangible assets acquired.

We may be unable to ensure compliance with United States economic sanctions laws, especially when we sell our products to distributors over which we have limited control.

The U.S. Department of the Treasury’s Office of Foreign Assets Control administers certain laws and regulations that impose penalties upon U.S. persons and, in some instances, foreign entities owned or controlled by U.S. persons, for conducting activities or transacting business with certain countries, governments, entities or individuals subject to U.S. economic sanctions, or U.S. Economic Sanctions Laws. We will not use any proceeds, directly or indirectly, from sales of our common shares, to fund any activities or business with any country, government, entity or individual with respect to which U.S. persons or, as appropriate, foreign entities owned or controlled by U.S. persons, are prohibited by U.S. Economic Sanctions Laws from conducting such activities or transacting such business.

However, we sell our products in international markets through independent non-U.S. distributors which are responsible for interacting with the end-users of our products. We may not be able to ensure that such non-U.S. distributors comply with all applicable U.S. Economic Sanctions Laws. Moreover, if a U.S. distributor conducts activities or transacts business with a country, government, entity or individual subject to U.S. economic sanctions, such actions may violate U.S. Economic Sanctions Laws. As a result of the foregoing, actions could be taken against us that could materially and adversely affect our reputation and have a material adverse effect on our business, financial condition, results of operations and prospects.

We may be classified as a passive foreign investment company, which could result in adverse U.S. federal income tax consequences to U.S. Holders of our common shares.

Based on the market price of our common shares, the value of our assets and the composition of our income and assets, we do not believe we were a “passive foreign investment company,” or PFIC, for U.S. federal income tax purposes for our taxable year ended December 31, 2017. However, the application of the PFIC rules is subject to uncertainty in several respects, and we cannot assure you we will not be a PFIC for any taxable year. A non-U.S. corporation will be a PFIC for any taxable year if either (i) at least 75% of its gross income for such year is passive income or (ii) at least 50% of the value of its assets (based on a quarterly average) during such year is attributable to assets that produce passive income or are held for the production of passive income. We must make a separate determination after the close of each year as to whether we were a PFIC for that year. The composition of our income and assets will be affected by how, and how quickly, we use any cash we generate from our operations or raise in any offering. Because the value of our assets for purposes of the PFIC test will generally be determined by reference to the market price of our common shares, fluctuations in the market price of our common shares may cause us to become a PFIC for any subsequent year. If we are a PFIC for any year during which a U.S. Holder (as defined in “Item 10. Additional Information — E. Taxation — United States Federal Income Taxation”) holds our common shares, certain adverse U.S. federal income tax consequences could apply to such U.S. Holder. Please see “Item 10. Additional Information — E. Taxation — United States Federal Income Taxation — Passive Foreign Investment Company.”

Negative publicity regarding vaccinations in China may lead to lower demand for vaccination, which could in turn negatively affect our business, financial condition and results of operations.

In December 2013, it was reported that several infants died shortly after receiving inoculations of hepatitis B vaccine produced by a domestic company in China. The PRC State Food and Drug Administration, or CFDA, and National Health and Family Planning Commission have determined that the inoculated hepatitis B vaccines comply with the applicable regulatory standards. In March 2016, media reported on improperly stored vaccines illegally sold in Shandong province and all across China. The illegal distribution started in 2010 and two suspects were detained by police in 2015. Although experts from the World Health Organization, or WHO, has confidence in China’s vaccine industry and publicly clarified their position several times since news of this scandal broke, public concerns remain. Such negative publicity may lead to lower demand for vaccination in China, which could in turn negatively affect the vaccine industry and our business, financial condition and results of operations.

As a foreign private issuer, we are subject to different U.S. securities laws and NASDAQ listing rules than domestic U.S. issuers.

As a foreign private issuer, we are exempt from the rules under the Exchange Act prescribing the furnishing and content of quarterly reports and proxy statements, and officers, directors and principal shareholders are exempt from the reporting and short-swing profit recovery provisions contained in Section 16 of the Exchange Act. In addition, as an Antigua and Barbuda company listed on the NASDAQ Global Select Market, we are subject to NASDAQ’s corporate governance requirements. However, NASDAQ listing rules permit a foreign private issuer like us to elect to follow home country corporate governance practices in lieu of certain NASDAQ corporate governance standards, subject to certain conditions. Certain corporate governance practices in Antigua and Barbuda, which is our home country, may differ significantly from the NASDAQ standards. As a result of our status as a foreign private issuer, you may not be afforded the same information or protections that would be made available to you were you investing in a domestic U.S. issuer.

Risks Related to Government Regulation

We may not be able to comply with applicable GMP standards and other regulatory requirements, which could have a material adverse effect on our business, financial condition and results of operations.

We are required to comply with applicable GMP regulations, which include, among other things, requirements relating to personnel, premises and equipment, raw material and products, qualification and validation, document management, production management, quality control and assurance and product distribution and recall. Manufacturing facilities must be approved by governmental authorities before they can be used to commercially manufacture our products and are subject to inspection by regulatory agencies. We have been required to comply with the new GMP standards implemented by CFDA since March 1, 2011. All vaccine manufacturers were required to meet the new GMP standards and obtain certifications for their manufacturing facilities by December 31, 2013. Any manufacturer that failed to meet the deadline would be forced to suspend production.

We have obtained the new GMP certificates for all of our commercial production facilities. However, we cannot assure you that we will be able to continue to meet the applicable GMP standards and other regulatory requirements in the future. In addition, in light of the incident where vaccines were illegally sold and distributed in Shandong province and other provinces around China in 2016, the government has changed policies and regulations related to the vaccine sales and distribution in China. Before the policy was issued, human vaccine sales were halted in China for months. Although the vaccine purchase and delivery was resumed in second half of 2016, we are not able to estimate whether any other change of policies and regulations on our business will negatively impact on business in the future.

If we fail to comply with applicable regulatory requirements at any stage during the regulatory process, including following any product approval, we may be subject to sanctions, including:

- fines;
- product recalls or seizures;
- injunctions;
- refusal of regulatory agencies to review pending market approval applications or supplements to approval applications;
- total or partial suspension of production;
- civil penalties;
- withdrawals of previously approved marketing applications; and
- criminal prosecution.

We can only sell products that have received regulatory approvals. Many factors affect our ability to obtain such approvals.

Pre-clinical and clinical trials of our products, and the manufacturing and marketing of our products, are subject to extensive, costly and rigorous regulation by governmental authorities in the PRC and in other countries. Even if we complete pre-clinical and clinical trials successfully, we may not be able to obtain applicable regulatory approvals. We cannot market any product candidate until we have both completed our clinical trials and obtained the necessary regulatory approvals for that product candidate.

Conducting clinical trials and obtaining regulatory approvals are uncertain, time-consuming and expensive processes. The process of obtaining required regulatory approvals from the CFDA and other regulatory authorities often takes many years and can vary significantly based on the type, complexity and novelty of the product candidates. For example, it took us approximately ten years to develop and obtain regulatory approval to commercialize Healive, and it took us five and a half years and four and a half years to develop and obtain regulatory approvals to commercialize Bilive and Anflu, respectively. EV71 vaccine, above all, took us eight years from 2008 to 2016 to develop and obtain regulatory approvals.

There can be no assurance that all of the clinical trials pertaining to our vaccines in development will be completed within the timeframes currently anticipated by us. We could encounter difficulties in enrolling vaccinees for clinical trials or encounter setbacks while conducting clinical trials that result in delays or cancellation. Data obtained from pre-clinical and clinical studies are subject to varying interpretations that could delay, limit or prevent regulatory approval, and failure to observe regulatory requirements or inadequate manufacturing processes are examples of other problems that could prevent approval. In addition, we may encounter delays or rejections in the event of additional regulation from future legislation, administrative action or changes in the CFDA policy or if unforeseen health risks become an issue with the participants of clinical trials.

Clinical trials may also fail at any stage. Results of early trials frequently do not predict results of later trials, and acceptable results in early trials may not be repeated. For these reasons, we do not know whether regulatory authorities will grant approval for any of our product candidates in the future. In addition, production permits for our products are valid for only five years and we need to apply for renewal six months prior to their expiration. The process to approve our renewal applications could be lengthy and there is no assurance that we will be granted renewal in a timely manner or at all.

Delays in obtaining CFDA or foreign approvals of our products could result in substantial additional costs and adversely affect our ability to compete with other companies. Even if regulatory approval is ultimately granted, we may not maintain the approval and the approval may be withdrawn. Any approval received may also restrict the intended use and marketing of the product we want to commercialize.

Outside the PRC, our ability to market some of our potential products is contingent upon receiving marketing authorizations from the appropriate foreign regulatory authorities. For example, our hepatitis A vaccine, Healive, can be supplied to certain international organizations and is eligible to participate into the tender process in some countries as it has passed the WHO prequalification assessment, or WHO PQ. However, there are still many other countries that require additional marketing authorization to sell in such countries despite the WHO PQ status. These foreign regulatory approval processes include the risks associated with the CFDA approval process described above and may include additional risks.

Because the medical conditions that our vaccines are intended to prevent represent significant public health threats, we are at risk of governmental actions detrimental to our business, such as product seizure, compulsory licensing and additional regulations.

In response to a pandemic or the perceived risk of a pandemic, governments in the PRC and other countries may take actions to protect their citizens that could affect our ability to control the production and export of pandemic vaccines or otherwise impose burdensome regulations on our business. For example, an outbreak of influenza could subject our manufacturing locations to seizure by the PRC government. The PRC government may also grant compulsory licenses to allow competitors to manufacture products that are protected by our patents or use our technology developed using funds received from government agencies.

We deal with hazardous materials that may cause injury to others. These materials are regulated by environmental laws that may impose significant costs and restrictions on our business.

Our research and development programs and manufacturing operations involve the controlled use of potentially harmful biological materials and other hazardous materials. We cannot eliminate the risk of accidental contamination or injury to our employees or others from the use, manufacture, storage, handling or disposal of hazardous materials and certain waste products. In the event of contamination or injury, we could be held liable for any resulting damages, and any liability could exceed our resources or any applicable insurance coverage we may have.

We are also subject to PRC laws and regulations governing the construction and operation of production facilities that may have an impact on the environment and the use, manufacture, storage, handling or disposal of hazardous materials and waste products, such as the PRC Environmental Impact Assessment Law, the PRC Prevention and Control of Water Pollution Law and the PRC Environmental Protection Law, as well as waste-disposal standards set by relevant governmental agencies. It is likely that China will adopt stricter pollution controls as the country is experiencing increasingly serious environmental pollution. Although we passed an environmental examination of our facilities conducted in 2004 by the Beijing Municipal Environment Protection Bureau on our hepatitis A vaccine production line and passed the same examination on our seasonal flu vaccine production line and filling and packaging line in 2005 and 2008, respectively, we cannot assure you that we will continue to pass similar environmental examinations on any future production facilities that we may construct. In addition, according to the PRC Environmental Impact Assessment Law, after the approval of previous environmental impact assessment report, if there is any material change in the nature, scale, location, production technology used and measures adopted to prevent damages to ecology, new environmental impact assessment reports need to be filed for approval.

We have already obtained the approval of the environmental impact assessment report from the Beijing Municipal Environment Protection Bureau for the construction plan of our facilities in Changping District, Beijing. We produce Bilive vaccine at our production facility for hepatitis A vaccine and produce Panflu and Panflu.1 vaccines at our production facility for seasonal flu or Anflu vaccine. We have canceled the construction plan for our influenza vaccine production facility in Changping. A new environmental impact assessment report regarding the change has been submitted to the relevant environment protection authorities and has passed the government inspection. We also added a sIPV production facility to the Changping construction plan. The relevant environmental impact assessment report was submitted to the relevant government authorities and passed the government evaluation. The approval on this report was already obtained. Once the construction of sIPV is completed, we will apply for government inspection on the completion of the plant.

In addition, we have obtained approval for the environmental impact assessment report for PPV production facility at our Shangdi site. We are required to pass the government inspection to launch the commercial production of PPV. If we fail to pass the inspection, we cannot commence commercial production of the product. Moreover, we do not currently have a pollution and remediation insurance policy to mitigate any risk related to environmental pollution or violation of environmental law.

Failure to commence development of land which we have been granted right to use within the required timeframe may cause us to lose our land use rights.

Sinovac Dalian was granted land use rights to two parcels of land, with an aggregate area of 95,686 square meters (approximately 1,030,000 square feet) located in the Economic and Technical Development Zone of Dalian, Liaoning province by the local government. According to the relevant PRC regulations, a parcel of land may be treated as idle land if development of the land has not been commenced within one year after the commencement date stipulated in the land use rights grant contract or the issuance date of the construction land approval certificate. Land users can extend the deadline for commencing the construction work for one year.

All of our current facilities of Sinovac Dalian are located at one of the two parcels of the land with an aggregated area of 55,606 square meters (598,582 square feet). However, as of the date of this annual report, we have not commenced development of the other parcel of the land with 40,080 square meters (431,418 square feet), which Sinovac Dalian was granted the right to use. The PRC government may treat the land as idle land, in which case we may be required to pay idle land fees or penalties, change the intended use of the land, find another parcel of land, or even be required to forfeit the land to PRC government, any of which would adversely affect our financial condition.

Negative publicity regarding China-based companies listed in the United States may affect the trading price of our common shares and result in increased regulatory scrutiny of our business.

In the past, litigation and negative publicity surrounding companies with operations in China listed in the United States have resulted in declining stock prices for such companies. Various equity research organizations have published reports on China-based companies after examining their corporate governance practices, related party transactions, sales practices and financial statements that have led to special investigations and stock suspensions on national exchanges. Any similar scrutiny of us, regardless of merit, could result in a diversion of our management's attention from managing our core business, negative publicity, potential costs to defend ourselves against rumors, volatility and loss in the trading price of our common shares and increased directors' and officers' insurance premiums, any of which could materially and adversely affect our business, financial condition and results of operations.

Risks Related to Our Intellectual Property

If we are unable to protect our technologies from competitors with patents or other forms of intellectual property protection, our business may be harmed.

Our success depends, in part, on our ability to protect our proprietary technologies. We try to protect the technology that we consider important to our business by filing PRC patent applications and relying on trade secret and pharmaceutical regulatory protection.

We have a total of 51 issued patents and a number of pending patent applications relating to our vaccines in China. The process of seeking patent protection in China can be lengthy and expensive and we cannot assure you that our pending patent applications, or any patent applications we may make in the future with respect to other products, will result in issued patents, or that any patents issued in the future will be able to provide us with meaningful protection or commercial advantage. Our patent applications may be challenged, invalidated or circumvented in the future.

In addition to patents, we rely on trade secrets and proprietary know-how to protect our intellectual property. We have entered into confidentiality agreements (which include, in the case of employees, non-competition provisions) with many of our employees, consultants, outside scientific collaborators, sponsored researchers and other advisors. These agreements provide that all confidential information developed or made known to the individual during the course of the individual's relationship with us is to be kept confidential and not disclosed to third parties except in specific circumstances. In the case of our employees, the agreements provide that all of the technology which is conceived by the individual during the course of employment is our exclusive property. These agreements may not provide meaningful protection or adequate remedies in the event of unauthorized use or disclosure of our proprietary information. In addition, third parties could independently develop information and techniques substantially similar to ours or otherwise gain access to our trade secrets.

Our current or potential competitors, many of whom have substantial resources and have made substantial investments in competing technologies, could develop products that compete directly with our products despite our intellectual property rights.

Intellectual property rights and confidentiality protections in China may not be as effective as in the United States or other countries. Policing unauthorized use of proprietary technology is difficult and expensive, and we might need to resort to litigation to enforce or defend patents issued to us or to determine the enforceability, scope and validity of our proprietary rights or those of others. The experience and capabilities of PRC courts in handling intellectual property litigation varies, and outcomes are unpredictable. Further, such litigation may require significant expenditures of cash and management efforts and could harm our business, financial condition and results of operations. An adverse determination in any such litigation could materially impair our intellectual property rights and may harm our business, prospects and reputation.

We may be exposed to infringement or misappropriation claims by third parties which, if determined adversely to us, could cause substantial liabilities to us, or we may be unable to sell some of our products. Please see "Item 4. Information on the Company — B. Business Overview — Intellectual Property and Proprietary Technology."

Third parties may bring intellectual property infringement claims against us in the future.

Our commercial success depends significantly on our ability to operate without infringing the patents and other proprietary rights of third parties. Even after reasonable investigation, we may not know with certainty whether we have infringed upon a third party's patent due to the complexity of patent claims, the inadequacy of patent clearance search procedures in the PRC and the fact that a third party may have filed a patent application without our knowledge while that product was under development by us.

Patent applications are maintained in secrecy until their publication 18 months after the filing date. The publication of discoveries in the scientific or patent literature frequently occurs substantially later than the date on which the underlying discoveries were made and patent applications were filed. China, similar to many other countries, adopts the first-to-file system under which the first party to file a patent application (instead of the first to invent the subject invention) may be awarded a patent. There may also be technologies licensed to us or acquired by us that are subject to infringement, misappropriation or other claims by others which could damage our ability to rely on such technologies.

If a third party claims that we infringe upon its proprietary rights, any of the following may occur:

- we may become involved in time-consuming and expensive litigation, even if the claim is without merit;
- we may become liable for substantial damages for past infringement if a court decides that our technology infringes upon a competitor's patent;
- a court may prohibit us from selling or licensing our product without a license from the patent holder, which may not be available on commercially reasonable terms, if at all, or which may require us to pay substantial royalties or grant cross licenses to our patents;
- we may have to reformulate our product so that it does not infringe upon others' patent rights, which may not be possible or could be very expensive and time-consuming; and
- we may be subject to injunctions prohibiting the manufacture and sale of our products or the use of our technologies.

If any of these events occurs, our business will suffer and the market price of our common shares could decline.

The success of our business may depend on licensing vaccine components from, and entering into collaboration arrangements with, third parties. We cannot be certain that our licensing or collaboration efforts will succeed or that we will realize any revenue from them.

The success of our business strategy depends, in part, on our ability to enter into licensing and collaboration arrangements and to effectively manage the resulting relationships. Our ability to enter into agreements with commercial partners depends in part on our ability to convince them of the value of our technology and know-how. This may require substantial time and effort. While we anticipate expending substantial funds and management effort, we cannot assure you that strategic relationships will result or that we will be able to negotiate additional strategic agreements in the future on acceptable terms, if at all.

We may incur significant financial commitments to collaborators in connection with potential licenses and sponsored research agreements. In addition, we may not be able to control the areas of responsibility undertaken by our strategic partners and may be adversely affected should these partners prove to be unable to carry a product candidate forward to full commercialization or should they lose interest in dedicating the necessary resources toward developing any such product quickly.

Third parties may terminate our licensing and other strategic arrangements if we do not perform as required under these arrangements. Generally, we expect that agreements for rights to develop technologies will require us to exercise diligence in bringing product candidates to market and may require us to make milestone and royalty payments that, in some instances, could be substantial. Our failure to exercise the required diligence or make any required milestone or royalty payments could result in the termination of the relevant license agreement, which could have a material adverse effect on us and our operations. In addition, these third parties breach or terminate their agreements with us or otherwise fail to conduct their activities in connection with our relationships in a timely manner. If we or our partners terminate or breach any of our licenses or relationships, we may:

- lose our rights to develop and market our product candidates;
- lose patent and/or trade secret protection for our product candidates;
- experience significant delays in the development or commercialization of our product candidates;
- not be able to obtain any other licenses on acceptable terms, if at all; and
- incur liability for damages.

Licensing arrangements and strategic relationships in our industry can be complex, particularly with respect to intellectual property rights. Disputes may arise in the future regarding ownership rights to technology developed by or with other parties. These and other possible disagreements between us and third parties with respect to our licenses or our strategic relationships could lead to delays in the research, development, manufacture and commercialization of our product candidates. These disputes could also result in litigation or arbitration, both of which are time-consuming and expensive. Moreover, These third parties may pursue alternative technologies or product candidates either on their own or in strategic relationships with others in direct competition with us.

Any cessation or suspension of our collaborations with scientific advisors and academic institutions may increase our costs in research and development, lengthen our new vaccines development process and lower our efficiency in new products development.

We work with scientific advisors and academic collaborators who assist us in some of our research and development efforts. Some of our pre-clinical and research programs rely heavily on such collaborators and we generally benefit considerably from the resources, technology and experience these collaborations can provide. These scientists are not, however, our employees and may have other commitments that limit their availability to us. If a conflict of interest arises between their work for us and their work for another entity, we may lose the services of these scientists and institutions. Any cessation or suspension of our collaborations with scientific advisors and academic institutions may increase our research and development costs, lengthen our new vaccines development process and lower our efficiency in new products development. In addition, although our scientific advisors and academic collaborators generally sign agreements not to disclose our confidential information, valuable proprietary knowledge may become publicly known which would compromise our competitive advantage.

We may lose the right to use “科兴” (Kexing) on our vaccine products and/or as part of our trade name.

We currently use “科兴” (Kexing) as part of Sinovac Beijing’s Chinese trade name in the PRC. We also use “科兴” (Kexing) as part of the Chinese trade name of Sinovac Dalian in the PRC. Shenzhen Kexing currently owns the “科兴” trademark registered in China for Class 5 (Pharmaceuticals) under the International Classification of Goods and Services. To protect our interest in using “科兴” in our trade name, we applied to register “科兴” in China for Class 42 (Scientific & Technological Services & Research) in 2006 and the PRC Trademark Office of the State Administration for Industry and Commerce approved our application in 2010. The “科兴” trademark owned by Shenzhen Kexing has not been identified as “Well-known Trademark” by the relevant PRC authorities since we first started using “科兴” in the trade name of Sinovac Beijing in 2001. If the “科兴” trademark owned by Shenzhen Kexing is ever officially identified as a “Well-Known Trademark,” however, we may be subject to trademark infringement claim for the use of “科兴” in our trade name. Although the trademark application and the trade name approval systems are administered separately in China, it is possible that we may lose our ability to use the “科兴” trademark in our trade name due to a successful trademark infringement claim, which may adversely affect our ability to maintain and protect our brands, cause us to incur litigation costs and divert resources and management attention.

Risks Related to Doing Business in China

Adverse changes in political, economic and other policies of the PRC government could have a material adverse effect on the overall economic growth of China, which could reduce the demand for our products and materially and adversely affect our competitive position.

We conduct all our operations in China, and generate approximately 99.2% of our sales in China. Accordingly, our business, financial condition, results of operations and prospects are affected significantly by economic, political and legal developments in China. The Chinese economy differs from the economies of most developed countries in many respects, including:

- the extent of government involvement;
- the level of development;
- the growth rate;
- the control of foreign exchange;

- the allocation of resources;
- an evolving regulatory system; and
- a lack of sufficient transparency in the regulatory process.

While the Chinese economy has experienced significant growth in the past 30 years, growth has been uneven, both geographically and among various sectors of the economy. The PRC government has implemented measures to encourage economic growth and guide the allocation of resources. Some of these measures benefit the overall Chinese economy, but may also have a negative effect on us. For example, our financial condition and results of operations may be adversely affected by government control over capital investments or changes in tax regulations that are applicable to us.

The Chinese economy has been transitioning from a planned economy to a more market-oriented economy. Although in recent years the PRC government has implemented measures emphasizing the utilization of market forces for economic reform, the reduction of state ownership of productive assets and the establishment of sound corporate governance in business enterprises, the Chinese government still owns a substantial portion of the productive assets in China. The continued control of these assets and other aspects of the national economy by the PRC government could materially and adversely affect our business. The PRC government also exercises significant control over Chinese economic growth by allocating of resources, controlling payment of foreign currency-denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies. Efforts by the PRC government to slow the pace of growth of the Chinese economy could result in hospitals spending less, which in turn could reduce demand for our products.

The political relationship among foreign countries and China is subject to sudden fluctuations and periodic tensions. Changes in political conditions in China and changes in the state of foreign relations are difficult to predict and could adversely affect our product export and international collaborations. This could lead to a decline in our profitability in the future.

Although the Chinese economy has grown significantly in the past decade, that growth may not continue, as evidenced by the slowing of the growth of the Chinese economy since 2012. Any adverse change in the economic conditions or government policies in China could have a material adverse effect on overall economic growth and the level of healthcare investments and expenditures in China, which in turn could lead to a reduction in demand for our products and consequently have a material adverse effect on our businesses.

Future changes in laws, regulations or enforcement policies in China could adversely affect our business.

Laws, regulations and enforcement policies in China, including those regulating our business, are evolving and subject to future change. Future changes in laws, regulations or administrative interpretations, or stricter enforcement policies by the PRC government, could impose more stringent requirements on us, including fines or other penalties. Changes in applicable laws and regulations may also increase our operating costs. Compliance with such requirements could impose substantial additional costs or otherwise have a material adverse effect on our business, financial condition and results of operations. These changes may relax some requirements, which could be beneficial to our competitors or could lower market entry barriers and increase competition. Further, regulatory agencies in China may, sometimes abruptly, change their enforcement practices.

Prior enforcement activity, or lack of enforcement activity, is not necessarily predictive of future actions. Any enforcement actions against us could have a material adverse effect on us and the market price of our common shares. In addition, any litigation or governmental investigation or enforcement proceedings in China may be protracted and may result in substantial costs and diversion of resources and management attention, negative publicity, damage to our reputation and decline in the price of our common shares.

We rely on dividends paid by our PRC subsidiaries for our cash needs. If they are unable to pay us sufficient dividends due to statutory or contractual restrictions on their abilities to distribute dividends to us, our various cash needs may not be met.

We are a holding company, and we rely on the dividends paid by our PRC subsidiaries, including majority-owned subsidiaries Sinovac Beijing and Sinovac Dalian and our wholly owned subsidiaries Sinovac R&D (formerly known as Sinovac Biological) and Sinovac Biomed for our cash needs, including the funds necessary to pay any dividends and other cash distributions to our shareholders, service any debt we may incur and pay our operating expenses. The payment of dividends in the PRC is subject to limitations. Regulations in the PRC currently permit payment of dividends by our PRC subsidiaries only out of accumulated profits as determined in accordance with accounting standards and regulations in China. For instance, in accordance with the regulations in China, Sinovac Beijing, Sinovac Dalian, Sinovac R&D and Sinovac Biomed are required to set aside at least 10% of its after-tax profits each year to contribute to its reserve fund until the accumulated balance of such reserve fund reaches 50% of the registered capital of each company.

As described above, a representative of Sinobioway Medicine, who is the Chairman of the board of directors of Sinovac Beijing, and dozens of unidentified individuals forcibly entered Sinovac Beijing's corporate offices and limited the physical movements of employees in Sinovac Beijing's general manager's office and finance department in an attempt to wrongfully take control of Sinovac Beijing's official seal, legal documents, accounting seal, financial documents and financial information systems. As a result of these actions, the ability of Sinovac Beijing to pay dividends for our cash needs may be materially impacted.

Sinovac Beijing, Sinovac Dalian, Sinovac R&D and Sinovac Biomed are required to set aside, at the discretion of their respective board of directors, a portion of their annual income after taxes to their employee welfare and bonus funds. These funds reduce the ability of the subsidiaries to pay dividends in cash. In addition, if Sinovac Beijing, Sinovac Dalian, Sinovac R&D or Sinovac Biomed incurs debt on its own behalf in the future, the instruments governing the debt may restrict either company's ability to pay dividends or make other distributions to us.

Restrictions on currency exchange may limit our ability to receive and use our revenues effectively.

We receive over 99% of our revenues in renminbi, which currently is not a freely convertible currency. A portion of our revenues may be converted into other currencies to meet our foreign currency obligations, including, among others, payment of dividends declared by our subsidiaries. Under China's existing foreign exchange regulations, Sinovac Beijing, Sinovac R&D, Sinovac Dalian and Sinovac Biomed are able to pay dividends in foreign currencies without prior approval from the State Administration of Foreign Exchange, or SAFE, by complying with certain procedural requirements. However, the PRC government could not take future measures to restrict access to foreign currencies for current account transactions.

Our PRC subsidiaries' ability to obtain foreign exchange is subject to significant foreign exchange controls and, in the case of amounts under the capital account, requires the approval of and/or registration with PRC government authorities, including SAFE. In particular, if we finance our PRC subsidiaries by means of foreign currency from us or other foreign lenders, the amount is not allowed to exceed the difference between the amount of total investment and the amount of the registered capital as approved by the Ministry of Commerce and registered with SAFE. Such loans must also be registered with SAFE. If we finance our PRC subsidiaries by means of additional capital contributions, the amount of these capital contributions must first be approved by the relevant government approval authority. These limitations could affect the ability of our PRC subsidiaries to obtain foreign exchange through debt or equity financing.

Fluctuation in the value of the renminbi may have a material adverse effect on your investment.

The value of the renminbi against the U.S. dollar, Euro and other currencies is affected by, among other things, changes in China's political and economic conditions and China's foreign exchange policies. The PRC government allows the renminbi to fluctuate within a narrow and managed band against a basket of certain foreign currencies. In recent years, the exchange rate between the renminbi and U.S. dollar has been relatively stable and consequently the renminbi has sometimes fluctuated sharply against other freely traded currencies, in tandem with the U.S. dollar.

Since June 2010, the Renminbi has fluctuated against the U.S. dollar. Since October 1, 2016, the RMB has joined the International Monetary Fund's basket of currencies that make up the Special Drawing Right, along with the U.S. dollar, the Euro, the Japanese yen and the British pound. In the fourth quarter of 2016, the RMB depreciated significantly in the backdrop of a surging U.S. dollar and persistent capital outflows of China. With the development of the foreign exchange market and progress towards interest rate liberalization and Renminbi internationalization, the PRC government may announce further changes to the exchange rate system and the RMB could appreciate or depreciate significantly in value against the U.S. dollar.

It is difficult to predict how long such depreciation of the RMB against the U.S. dollar may last and when and how the relationship between the renminbi and the U.S. dollar may change again. The PRC government indicated that it will make the foreign exchange rate of the renminbi more flexible and widen the trading band of renminbi, which increases the possibility of sharp fluctuations in renminbi's value in the future as well as the unpredictability associated with renminbi's exchange rate. There remains significant international pressure on the PRC government to adopt an even more flexible currency policy, which could result in further and more significant fluctuations of the renminbi against foreign currencies.

As the majority of our costs and expenses are denominated in renminbi, a resumption of the appreciation of the renminbi against the U.S. dollar would further increase our costs in U.S. dollar terms. In addition, as our operating subsidiaries in China receive revenues in renminbi, any significant depreciation of the renminbi against the U.S. dollar may have a material adverse effect on our revenues in U.S. dollar terms and financial condition, and the value of, and any dividends payable on, our common shares. For example, to the extent that we need to convert U.S. dollars into renminbi for our operations, appreciation of the renminbi against the U.S. dollar would have an adverse effect on the renminbi amount we receive from the conversion. Conversely, if we decide to convert our renminbi into U.S. dollars for the purpose of making payments for dividends on our common shares or for other business purposes, appreciation of the U.S. dollar against the renminbi would have a negative effect on the U.S. dollar amount available to us.

Our business benefits from certain government tax incentives. Expiration, reduction or elimination of these incentives will increase our tax expenses and in turn decrease our net income.

Pursuant to the PRC Enterprise Income Tax Law, or the EIT Law, and its implementation rules, both domestic companies and the foreign invested enterprises, or the FIEs, are subject to a unified income tax rate of 25%. Tax exemption or reduction with fixed terms enjoyed by enterprises including us will continue until the expiration of the prescribed period. Preferential tax treatments will continue to be granted to high and new technology enterprises that conduct business in encouraged sectors, whether FIEs or domestic companies.

Sinovac Beijing reconfirmed its "High and New Technology Enterprises," or HNTE, status and obtained the corresponding certificate in 2014 for a period of three years. As a result, subject to satisfaction of applicable criteria as confirmed by the competent authorities, Sinovac Beijing was entitled to a reduced enterprise income tax, or EIT, rate of 15% from 2014 to 2016. Sinovac Beijing reconfirmed its HNTE status in 2017 for another three-year period, which is from 2017 to 2019. Sinovac Dalian, being confirmed as a HNTE in 2017 for a period of 3 years, is subject to the preferential EIT of 15% from 2017 to 2019. The PRC government could eliminate any of these preferential tax treatments before their scheduled expiration. Expiration, reduction or elimination of such tax incentives will increase our tax expenses and in turn decrease our net income.

Under the EIT Law, dividends payable by us and gains on the disposition of our shares may be subject to PRC taxation.

If we were considered a PRC resident enterprise under the EIT Law, our shareholders who are deemed non-resident enterprises may be subject to the EIT at the rate of 10% upon the dividends payable by us or upon any gains realized from the transfer of our shares, if such income is deemed derived from China, provided that (i) such foreign enterprise investor has no establishment or premises in China or (ii) it has an establishment or premises in China but its income derived from China has no real connection with such establishment or premises. If we were required under the EIT Law to withhold PRC income tax on our dividends payable to our non-PRC enterprise shareholders, or if any gains realized from the transfer of our shares by our non-PRC enterprise shareholders were subject to the EIT, such shareholders' investment in our shares would be materially and adversely affected.

PRC regulations relating to investments in offshore companies by PRC residents may subject our PRC-resident beneficial owners or our PRC subsidiaries to liability or penalties, limit our ability to inject capital into our PRC subsidiaries or limit our PRC subsidiaries' ability to increase their registered capital or distribute profits.

SAFE promulgated the Circular on Relevant Issues Concerning Foreign Exchange Control on Domestic Residents' Offshore Investment and Financing and Roundtrip Investment through Special Purpose Vehicles, or SAFE Circular 37, on July 4, 2014, which replaced the former circular commonly known as "SAFE Circular 75" promulgated by SAFE on October 21, 2005. SAFE Circular 37 requires PRC residents to register with the local branches of SAFE in connection with their direct establishment or indirect control of an offshore entity, for the purpose of overseas investment and financing, with such PRC residents' legally owned assets or equity interests in domestic enterprises or offshore assets or interests, referred to in SAFE Circular 37 as a "special purpose vehicle."

SAFE Circular 37 further requires amendment to the registration in the event of any significant changes with respect to the special purpose vehicle, such as increase or decrease of capital contributed by PRC individuals, share transfer or exchange, merger, division, or other material events. In the event that a PRC shareholder holding interests in a special purpose vehicle fails to fulfill the required SAFE registration, the PRC subsidiaries of that special purpose vehicle may be prohibited from making profit distributions to the offshore parent and from carrying out subsequent cross-border foreign exchange activities, and the special purpose vehicle may be restricted in its ability to contribute additional capital into its PRC subsidiary.

Failure to comply with the various SAFE registration requirements described above could result in liability under PRC law for evasion of foreign exchange controls. According to the Notice on Further Simplifying and Improving Policies for the Foreign Exchange Administration of Direct Investment released on February 13, 2015 by SAFE, local banks will examine and handle foreign exchange registration for overseas direct investment, including the initial foreign exchange registration and amendment registration, under SAFE Circular 37 from June 1, 2015. However, since this notice has not yet come into force, significant uncertainty exists with respect to its interpretation and implementation by governmental authorities and banks.

Mr. Weidong Yin has made the required SAFE registration with respect to his investments in our company. However, we may not be aware of the identities of all of our beneficial owners who are PRC residents. We do not control our beneficial owners and cannot assure you that all of our PRC-resident beneficial owners will comply with SAFE Circular 37 and subsequent implementation rules. The failure of our beneficial owners who are PRC residents to register or amend their foreign exchange registrations in a timely manner pursuant to SAFE Circular 37 and subsequent implementation rules, or the failure of future beneficial owners of our company who are PRC residents to comply with the registration procedures set forth in SAFE Circular 37 and subsequent implementation rules, may subject such beneficial owners or our PRC subsidiaries to fines and legal sanctions.

Furthermore, since SAFE Circular 37 was recently promulgated and it is unclear how this regulation, and any future regulation concerning offshore or cross-border transactions, will be interpreted, amended and implemented by the relevant PRC government authorities, we cannot predict how these regulations will affect our business operations or future strategy. Failure to register or comply with relevant requirements may also limit our ability to contribute additional capital to our PRC subsidiaries and limit our PRC subsidiaries' ability to distribute dividends to our company. These risks may have a material adverse effect on our business, financial condition and results of operations.

Any failure to comply with PRC regulations regarding our employee equity incentive plans may subject the PRC plan participants or us to fines and other legal or administrative sanctions.

Pursuant to SAFE Circular 37, PRC residents who participate in share incentive plans in overseas non-publicly-listed companies due to their position as director, senior management or employees of the PRC subsidiaries of the overseas companies may submit applications to SAFE or its local branches for the foreign exchange registration with respect to offshore special purpose companies. Our directors, executive officers and other employees who are PRC residents and who have been granted options and restricted shares were able to follow SAFE Circular 37 to apply for the foreign exchange registration before our company became an overseas listed company.

Since our company has become an overseas listed company, we and our directors, executive officers and other employees who are PRC residents and who have been granted options are subject to the Notice on Issues Concerning the Foreign Exchange Administration for Domestic Individuals Participating in Stock Incentive Plan of Overseas Publicly Listed Company, issued by SAFE in February 2012, according to which, employees, directors, supervisors and other management members participating in any stock incentive plan of an overseas publicly listed company who are PRC residents are required to register with SAFE through a domestic qualified agent, which could be a PRC subsidiary of such overseas listed company, and complete certain other procedures.

Failure to complete SAFE registrations may subject them to fines and legal sanctions and may also limit the ability to make payments under our equity incentive plans or receive dividends or sales proceeds related thereto, or our ability to contribute additional capital into our wholly-foreign owned enterprises in China and limit our wholly-foreign owned enterprises' ability to distribute dividends to us. We also face regulatory uncertainties that could restrict our ability to adopt additional equity incentive plans for our directors and employees under PRC law.

In addition, the State Administration for Taxation has issued circulars concerning employee share options or restricted shares. Under these circulars, employees working in the PRC who exercise share options, or whose restricted shares or restricted share units, or RSUs, vest, will be subject to PRC individual income tax. The PRC subsidiaries of an overseas listed company have obligations to file documents related to employee share options or restricted shares with relevant tax authorities and to withhold individual income taxes of those employees related to their share options, restricted shares or RSUs. If the employees fail to pay, or the PRC subsidiaries fail to withhold, their income taxes according to relevant laws, rules and regulations, the PRC subsidiaries may face sanctions imposed by the tax authorities or other PRC government authorities.

PRC regulation of loans and direct investment by offshore holding companies to PRC entities may delay or prevent us from making loans or additional capital contributions to our PRC operating subsidiaries and affiliated entities.

In funding our PRC subsidiaries, we must comply with PRC legal requirements relating to foreign debt registration and to PRC foreign-investment companies' "registered capital" and "total investment." "Registered capital" refers to the capital contributed to or paid into a PRC foreign-investment company in cash or in kind, and "total investment" refers to the amount of a PRC foreign-investment company's registered capital plus all external borrowings by such company. The amounts of a PRC foreign-investment company's registered capital and total investment are set forth in the company's constitutional documents and approved by the competent government authority in advance and, in the case of Sinovac Beijing and Sinovac Dalian, must be approved by their minority shareholders, as well as Sinobioway Medicine (formerly named Xiamen Bioway Group Co., Ltd) or Dalian Jin Gang Group, respectively, as well.

Loans by us or Sinovac Hong Kong to Sinovac Beijing, Sinovac R&D, Sinovac Dalian or Sinovac Biomed cannot exceed the difference between such company's registered capital and total investment, unless the company has obtained the approval of the approval authority and, in the case of Sinovac Beijing or Sinovac Dalian, the approval of Sinobioway Medicine or Dalian Jin Gang Group, respectively, to increase the amount of total investment. Further, such loans must be registered with SAFE or its local counterpart.

We may also decide to finance our PRC subsidiaries by making additional capital contributions. These additional contributions must be approved by the government approval authority and, in the case of Sinovac Beijing or Sinovac Dalian, by Sinobioway Medicine or Dalian Jin Gang Group, respectively. We cannot assure you that we will be able to obtain these government registrations or approvals, or the approval of Sinobioway Medicine or Dalian Jin Gang Group, on a timely basis, if at all, with respect to future loans or additional capital contributions by us to our subsidiaries or affiliates. If we fail to obtain such registrations or approvals, our ability to capitalize our PRC operations would be negatively affected, which could adversely and materially affect the liquidity of our subsidiaries and our ability to expand our business.

Because we are incorporated under Antigua and Barbuda law, substantially all of our operations, property and assets are located in China and all of our directors and officers and substantially all of their assets are located outside of the United States, you may be unable to protect your shareholder rights under U.S. law in a court in the United States.

We are incorporated in Antigua and Barbuda. Our corporate affairs are governed by our Articles of Incorporation and By-laws and by the International Business Corporations Act and common law of Antigua and Barbuda. The rights of shareholders to take legal action against our directors, officers and us, actions by minority shareholders and the fiduciary responsibilities of our directors to us are to a large extent governed by the International Business Corporations Act and common law of Antigua and Barbuda. The common law of Antigua and Barbuda is derived in part from comparatively limited judicial precedent in Antigua and Barbuda as well as from English common law, which has persuasive, but not binding, authority on a court in Antigua and Barbuda.

The rights of our shareholders and the fiduciary responsibilities of our directors under Antigua and Barbuda law are not as clearly established as they would be under statutes or judicial precedents in the United States. Among other things, Antigua and Barbuda has a less developed body of securities laws as compared to the United States, and provides significantly less protection to investors. Further, Antigua and Barbuda's body of securities law, and the experience of its courts in addressing corporate and securities law issues of a type often experienced by public companies, is likely less developed than that of some of the other jurisdictions where publicly traded China-based companies are incorporated, such as the Cayman Islands.

It may be difficult or impossible for you to bring an action against us or our directors or officers in Antigua and Barbuda or to enforce or protect your rights under U.S. securities laws or otherwise. Even if you are successful in bringing an action of this kind, you may be unable to enforce a judgment against our assets or the assets of our directors and officers under the laws of Antigua and Barbuda.

There is doubt as to whether Antigua and Barbuda courts would enforce judgments of United States courts obtained in actions against us or our directors or officers that are predicated upon the civil liability provisions of the Securities Act, or in original actions brought against us or such persons predicated upon the Securities Act. There is no treaty in effect between the United States and Antigua and Barbuda providing for such enforcement, and there are grounds upon which Antigua and Barbuda courts may not enforce judgments of United States courts. In addition, Antigua and Barbuda corporations may not have standing to initiate a shareholder derivative action before the federal courts of the United States.

PRC courts may recognize and enforce foreign judgments in accordance with the PRC Civil Procedures Law based either on treaties between the PRC and the country where the judgment is made or on reciprocity between jurisdictions. If there are no treaties or reciprocity arrangements between the PRC and a foreign jurisdiction where a judgment is rendered, matters relating to the recognition and enforcement of the foreign judgment in the PRC may be resolved through diplomatic channels. The PRC does not have any treaties or other arrangements with the United States or Antigua and Barbuda that provide for the reciprocal recognition and enforcement of foreign judgments. As a result, it is generally difficult to enforce in the PRC a judgment rendered by a U.S. or Antigua and Barbuda court.

As a result of all of the above, as well as the fact that substantially all of our property, assets and operations are located in China and all of our directors and officers and substantially all of their assets are located outside of the United States, you may be unable to protect your shareholder interests through actions against us or our management, directors or major shareholders.

We may be adversely affected by the final outcome of the administrative proceedings brought by the SEC against Ernst & Young Hua Ming LLP and other accounting firms in China.

In December 2012, the SEC initiated administrative proceedings against the China affiliates of five accounting firms, including our independent registered public accounting firm, Ernst & Young Hua Ming LLP, alleging that they refused to produce audit work papers and other documents related to certain China-based companies under investigation by the SEC for potential accounting fraud, and thus violated U.S. securities laws and SEC rules and regulations. On January 22, 2014, an SEC administrative law judge ruled in favor of the SEC, issuing an initial decision which censured each of the accounting firms for failure to provide their audit work papers to the SEC and ordered a six-month suspension of Ernst & Young Hua Ming LLP's and the other China-based affiliates of the Big Four accounting firms' right to practice before the SEC. On February 12, 2014, four of these China-based accounting firms appealed to the SEC against this decision. In February 2015, each of the four China-based accounting firms agreed to a censure and to pay a fine to the SEC to settle the dispute and avoid suspension of their ability to practice before the SEC.

The firms' ability to continue to serve all their respective clients is not affected by the settlement. The settlement stays the current proceeding for four years, during which time the firms are required to follow detailed procedures to seek to provide the SEC with access to Chinese firms' audit documents via China Securities Regulatory Commission. If a firm does not follow the procedures, the SEC could impose penalties such as suspensions, or it could restart the administrative proceedings or commence a new, expedited administrative proceeding against the non-compliant firm. The settlement did not require the firms to admit to any violation of law and preserves the firms' legal defenses in the event the administrative proceeding is restarted.

In the event that the SEC restarts the administrative proceedings, depending upon the final outcome, listed companies in the United States with major PRC operations may find it difficult or impossible to retain auditors in respect of their operations in the PRC, which could result in financial statements being determined to not be in compliance with the requirements of the Exchange Act, including possible delisting. Moreover, any negative news about the proceedings against these audit firms may cause investor uncertainty regarding China-based, United States-listed companies and the market price of our common shares may be adversely affected.

If, as a result of this or any other action, the SEC suspends the right of Ernst & Young Hua Ming LLP to practice before the SEC, our ability to file financial statements in compliance with SEC requirements could be impacted. If none of the China-based auditors are able to continue to act as auditors for Chinese companies listed in the U.S., we may not be able to meet the reporting requirements under the Exchange Act, which may ultimately result in our deregistration by the SEC and delisting from the NASDAQ Stock Market, which would substantially reduce or effectively terminate the trading of our common shares in the United States. Moreover, any negative news about the proceedings against these audit firms may erode investor confidence in China-based, United States listed companies and the market price of our common shares may be adversely affected.

We and our investors may be adversely affected by the inability of the Public Company Accounting Oversight Board, or PCAOB, to carry out inspections of Ernst & Young Hua Ming LLP and other accounting firms in China.

Under the Sarbanes Oxley Act, auditors of companies whose shares are publicly traded in the United States, including our independent registered public accounting firm, Ernst & Young Hua Ming LLP, are required to register with PCAOB and to undergo regular inspections by PCAOB to assess compliance with applicable U.S. legal and accounting professional standards. As PCAOB is currently unable to conduct inspections in China, Ernst & Young Hua Ming LLP has not yet been inspected by PCAOB. PCAOB inspections of other audit firms in other jurisdictions have identified deficiencies in the audit and quality control procedures of those firms, which may be addressed to improve future audit quality. The inability of PCAOB to conduct inspections of independent registered public accounting firms operating in China makes it more difficult to evaluate the effectiveness of our auditor's audit or quality control procedures. As a result, investors in our common shares may have less confidence in our publicly reported financial information and procedures and the quality of our financial statements.

In addition, PCAOB may choose to impose sanctions or take other actions against Ernst & Young Hua Ming LLP, including suspending or revoking Ernst & Young Hua Ming LLP's registration with PCAOB. If Ernst & Young Hua Ming LLP and other China-based auditors are unable to maintain registration with PCAOB, we may be unable to meet the ongoing reporting requirements under the Exchange Act, which ultimately may result in the termination of the registration of our common shares and ordinary shares under the Exchange Act or the delisting of our common shares from NASDAQ, or both, which would substantially reduce or effectively terminate the trading of our common shares in the United States.

ITEM 4. INFORMATION ON THE COMPANY

A. History and Development of the Company

Our legal and commercial name is Sinovac Biotech Ltd. Our principal executive offices are located at No. 15, Zhi Tong Road, Zhongguancun Science & Technology Park, Changping District, Beijing 102200, PRC. Our telephone number at this address is +86-10-5693-1800. Our registered address is located at The Colony House, 41 Nevis Street, St. John's in Antigua and Barbuda. Our agent for service of process in the United States is Law Debenture Corporate Services Inc., located at 801 2nd Avenue, Suite 403, New York, NY 10017.

We are a holding company and conduct our business in China through our 73.09% majority-owned subsidiary Sinovac Beijing, our wholly owned subsidiary Sinovac R&D, our 67.86% majority-owned subsidiary Sinovac Dalian, and our wholly owned subsidiaries Sinovac Biomed and Sinovac Hong Kong. Sinovac Beijing was incorporated on April 28, 2001, Sinovac R&D was incorporated on May 7, 2009, Sinovac Dalian was established on January 19, 2010, Sinovac Biomed was incorporated on April 16, 2015 and Sinovac Hong Kong was incorporated on October 21, 2008.

We were incorporated in Antigua and Barbuda on March 1, 1999 as an Antiguan company with limited liability under the laws of Antigua and Barbuda. Before we adopted our current name on October 21, 2003, we were called Net-Force System Inc. and were primarily engaged in the online gaming business. We were quoted on the OTC Bulletin Board on February 21, 2003. In September 2003, we issued ten million new shares to Lily Wang, one of our then principal shareholders to acquire a 51% equity interest in Sinovac Beijing. Ms. Wang had contracted to purchase these shares from certain of Sinovac Beijing's then shareholders for cash immediately before the above 51% share transfer. However, this 51% equity interest in Sinovac Beijing was transferred to us directly from those shareholders and was recorded under applicable PRC law transfer documents as a cash transaction. Lily Wang was responsible for paying the cash to those shareholders. The transfer of the Sinovac Beijing equity interest to us was registered and approved by PRC government authorities in August 2004. In September 2004, we acquired an additional 20.6% equity interest in Sinovac Beijing for approximately \$3.3 million in cash. In October 2011, we further acquired an additional 1.53% equity interest in Sinovac Beijing by contributing the dividends declared to Sinovac Hong Kong but unpaid in amount of RMB18.6 million (\$2.9 million). We currently own 73.09% of the equity interests in Sinovac Beijing and Sinobioway Medicine owns a 26.91% interest.

In January 2004, we entered into a share purchase agreement with Heping Wang and issued him 3.5 million of our common shares and a promissory note in the amount of \$2.2 million to acquire from him a 100% equity interest in Tangshan Yian. Mr. Wang had contracted to purchase these shares from Tangshan Yian's then two shareholders immediately before the above 100% share transfer. However, this 100% equity interest in Tangshan Yian was transferred to us directly from those shareholders and was recorded under applicable PRC law transfer documents as a cash transaction. Heping Wang was responsible for paying the cash to the two shareholders. The transfer of the Tangshan Yian equity interest by Mr. Wang to us was registered and approved by PRC government authorities in November 2004.

In the first quarter of 2008, we issued and sold an aggregate of 2.5 million common shares at \$3.90 per share to Sansar Capital Management. We received approximately \$9.75 million in gross proceeds from this private placement of our common shares.

In October 2008, we established Sinovac Hong Kong, a wholly owned subsidiary focused primarily on registering and distributing current and newly-developed vaccine products in Hong Kong and exporting our products abroad. In addition, Sinovac Hong Kong seeks research and development collaboration opportunities with third parties in Hong Kong.

In May 2009, Sinovac R&D was incorporated with a registered capital of \$5 million. In 2016, our board of directors approved an additional capital contribution of \$4.6 million by us. To date, we have invested RMB10.0 million (or \$1.44 million) with the remaining part to be provided in due course.

In November 2009, we entered into an agreement with Dalian Jin Gang Group to establish Sinovac Dalian. In January 2010, we established Sinovac Dalian which focuses on the research, development, manufacturing and commercialization of live attenuated vaccines, such as varicella and mumps vaccines for human use. Pursuant to the joint venture agreement, we made an initial cash contribution of RMB60.0 million (\$9.3 million) in exchange for a 30% equity interest in Sinovac Dalian and Dalian Jin Gang Group made an asset contribution of RMB140.0 million (\$21.6 million), including manufacturing facilities, production lines and land use rights, in exchange for the remaining 70% interest in Sinovac Dalian.

In December 2010, we purchased an additional 25% equity interest in Sinovac Dalian from Dalian Jin Gang Group for consideration of RMB50.0 million (\$7.7 million). In 2014, the board of directors passed a resolution to increase our capital contribution to Sinovac Dalian in the amount of RMB80.0 million (\$12.8 million), which will increase Sinovac's equity ownership from 55% to 67.86%. RMB50.0 million (\$7.7 million) was initially provided through foreign debt with the expectation of a debt to equity swap of the total amount after the remaining RMB30.0 million (\$4.6 million) is provided to Sinovac Dalian. In 2016, an additional RMB30.0 million was made to Sinovac Dalian through foreign debt and subsequently the debt to equity swap for a total of RMB80.0 million was completed. In October 2016, our equity ownership in Sinovac Dalian increased to 67.86%.

In February 2010, we closed a public offering of our common shares. We issued and sold 11.5 million common shares at \$5.75 per share. We received net proceeds of approximately \$61.8 million, after deducting underwriting discounts and commissions and offering expenses payable by us.

In 2013, we increased the capital investment to Tangshan Yian with the total amount of \$4 million, which we lent to Tangshan in 2010. In the same year, we lent Tangshan Yian \$1 million to be used for sales and marketing spending and other corporate purposes operational activities. In December 2015, Sinovac entered into an equity interest transfer agreement with Beijing Kuai Le Xing Biotech Co., Ltd. to transfer Sinovac's 100% equity interest in Tangshan Yian Biological Engineering Co., Ltd. to Beijing Kuai Le Xing Biotech Co., Ltd. for consideration of RMB13.0 million (\$1.9 million). As of the date of this annual report, we have received RMB11.0 million (\$1.7 million) and the remaining RMB2.0 million (\$0.3 million) is receivable from Beijing Kuai Le Xing Biotech Co., Ltd. The disposal of Tangshan Yian was completed in February 2016. As a result, Tangshan Yian's operating results and cash flows are presented as discontinued operations in Sinovac's financial results, and Tangshan Yian's assets and liabilities are presented as held for sale in Sinovac's financial results.

In April 2015, Sinovac established Sinovac Biomed Co., Ltd., which is 100% owned by Sinovac Biotech (Hong Kong) Ltd. Sinovac Biomed Co., Ltd. focuses on the distribution of vaccine products as well as providing consulting services in the vaccination industry.

In March 2016, we adopted our Rights Plan. Pursuant to our Rights Plan, subject to limited exceptions, upon (i) a person or group obtaining ownership of 15% or more of our common shares or (ii) the commencement or announcement of an intention to make a tender offer or exchange offer, the consummation of which would result in the beneficial ownership by a person or group of 15% or more of our common shares, in each case, without the approval of our board of directors, each Right will entitle the holders, other than the Acquiring Person, to buy, at an exercise price of \$30.00, one one-thousandth of a share of our newly created series A junior participating preferred shares, or the Series A Preferred Shares. Holders are entitled to receive, in lieu of each one one-thousandths of a Series A Preferred Share, common shares having a market value at that time of twice the Right's exercise price. Our board of directors is entitled to redeem the Rights at \$0.001 per Right at any time before the Rights are exercisable. We refer to the person who acquired 15% or more of the outstanding common shares of the Company as the "Acquiring Person." In March 2017, we amended our Rights Plan to extend its term for a 12-month period and, in March 2018, we amended it to extend its term for an additional 12-month period. In June 2017, we amended our Rights Plan in connection with the execution of the Amalgamation Agreement. As described above, on March 5, 2018, the Company filed a lawsuit in the Court of Chancery of the State of Delaware seeking a determination whether the Shareholder Group had triggered our Rights Plan by forming a group holding approximately 45% of the Company's outstanding shares, in excess of the plan's threshold of 15%, and acting in concert prior to the 2017 AGM.

On June 26, 2017, we entered into the Amalgamation Agreement with Parent and Amalgamation Sub, a wholly owned subsidiary of Parent. Pursuant to the Amalgamation Agreement, Parent will acquire Sinovac Biotech Ltd. for cash consideration equal to \$7.00 per common share. Subject to the terms and conditions of the Amalgamation Agreement, at the effective time of the Amalgamation, Amalgamation Sub will be amalgamated with and into Sinovac Biotech Ltd., with Sinovac Biotech Ltd. continuing as the surviving corporation and a wholly owned subsidiary of Parent and each of our common shares issued and outstanding immediately prior to the effective time of the Amalgamation will be cancelled in consideration for the right to receive \$7.00 per common share in cash, without interest and net of any applicable withholding taxes, except for (i) 6,049,500 common shares held by Mr. Weidong Yin and 10,780,820 common shares held by SAIF, (ii) common shares held by Parent, Parent's affiliates, or Sinovac Biotech Ltd. or any of its subsidiaries, which common shares, in each case, will be canceled without payment of any consideration or distribution therefor and (iii) common shares owned by holders who have validly exercised and not effectively withdrawn or lost their rights to dissent from the Amalgamation in accordance with the provisions of Section 191 of the International Business Corporations Act, CAP. 222 of the Revised Laws of Antigua and Barbuda (as consolidated and revised), or the IBCA, which common shares will be cancelled at the effective time of the Amalgamation for the right to receive the fair value of such common shares determined in accordance with the provisions of Section 191(4) or Section 195(2) of the IBCA, as applicable. Immediately following the Amalgamation, Parent will be beneficially owned by the Buyer Consortium.

Our board of directors, acting upon the unanimous recommendation of the Special Committee, unanimously approved the Amalgamation Agreement and the transactions contemplated by the Amalgamation Agreement, including the Amalgamation, and resolved to recommend that our shareholders authorize and approve the Amalgamation Agreement and the transactions contemplated by the Amalgamation Agreement, including the Amalgamation.

The Amalgamation is subject to customary closing conditions, including approval by an affirmative vote of holders of our common shares representing at least two-thirds of the shares present and voting in person or by proxy as a single class at a meeting of our shareholders, which will be convened to consider the authorization and approval of the Amalgamation Agreement and the transactions contemplated by the Amalgamation Agreement, including the Amalgamation, and the other closing conditions specified in the Amalgamation Agreement. If completed, the Amalgamation will result in Sinovac Biotech Ltd. becoming a privately-held company and our common shares will no longer be listed on NASDAQ.

On June 28, 2017, we received a written proposal, or the Sinobioway Proposal, from a consortium, or the Sinobioway Consortium, comprising (i) PKU V-Ming (Shanghai) Investment Holdings Co., Ltd., (ii) Shandong Sinobioway Biomedicine Co., Ltd., (iii) CICC Qianhai Development (Shenzhen) Fund Management Co., Ltd., (iv) Beijing Sinobioway Group Co., Ltd., (v) CITIC M&A Fund Management Co., Ltd., (vi) Heng Feng Investments (International) Limited and (vii) Fuerde Global Investment Limited, pursuant to which the Sinobioway Consortium proposed to acquire the Company in a transaction, or the Sinobioway Transaction, for cash consideration equal to \$8.00 per common share. During the course of the following three months, the Special Committee and its advisors sought to clarify the terms of the Sinobioway Proposal, including the financing of the Sinobioway Transaction, and the likelihood of consummating the Sinobioway Transaction, with the Sinobioway Consortium and its advisors. In late October 2017, the Special Committee determined, after consultation with its advisors, that negotiations with respect to the Sinobioway Proposal were not permitted under the Amalgamation Agreement, based on the information provided by the Sinobioway Consortium prior to such determination.

On March 26, 2018, we amended the Amalgamation Agreement to extend its termination date to April 26, 2018. On April 26, 2018, we further amended the Amalgamation Agreement to extend its termination date to May 26, 2018.

For additional information regarding our principal capital expenditures, see "— D. Property, Plants and Equipment."

Investor inquiries should be directed to us at the address and telephone number of our principal executive offices set forth above. Our website is <http://www.sinovac.com>. The information contained on our website does not form part of this annual report.

B. Business Overview

We are a fully integrated China-based biopharmaceutical company that focuses on the research, development, manufacturing and commercialization of vaccines that protect against human infectious diseases including, without limitation, hepatitis A, hepatitis B, hand foot and mouth disease caused by enterovirus 71, seasonal influenza, H5N1 and H1N1 pandemic influenza and mumps. In 2002, we launched our first product, Healive, which was the first inactivated hepatitis A vaccine developed, produced and marketed by a China-based manufacturer. In 2005, we received regulatory approvals for the production of Bilive in China, a combined hepatitis A and B vaccine, and Anflu, a split viron influenza vaccine. In April 2008, we received regulatory approval for the production in China of our whole viron H5N1 pandemic influenza (avian flu) vaccine, which is the only vaccine approved for sale to the Chinese national vaccine stockpiling program.

In September 2009, we were granted a production license for Panflu.1, which was the first approved vaccine in the world against the influenza A H1N1 virus (swine flu). In December 2011, Sinovac Dalian obtained the production license from the CFDA for its mumps vaccine product and launched the mumps vaccine in late 2012. In December 2015, CFDA issued the new drug certificate and production license for Inlive, our EV71 vaccine, and in January 2016, CFDA issued the GMP certificate. Our pipeline consists of various vaccine candidates in the pre-clinical and clinical development phases in China. We obtained the approvals to conduct clinical trials of PPV, pneumococcal conjugate vaccine, rubella vaccine, varicella vaccine, sIPV, and quadrivalent influenza vaccine in May 2014, January 2015, December 2014, October 2015, November 2015 and in November 2016, respectively.

Our Products

We specialize in the sales, marketing, manufacturing, and development of vaccines for infectious diseases with significant unmet medical need. Set forth below is a chart that outlines our current marketed products and those that we have developed or are developing.

| <u>Product</u> | <u>Indication</u> | <u>Pre-clinical</u> | <u>File IND</u> | <u>Obtain Clinical Approval from CFDA</u> | <u>Phase I</u> | <u>Phase II</u> | <u>Phase III</u> | <u>On sale</u> |
|---|--|---------------------|-----------------|---|----------------|-----------------|------------------|----------------|
| Healive | Hepatitis A | | | | | | | |
| Bilive | Hepatitis A&B | | | | | | | |
| Anflu | Influenza | | | | | | | |
| Panflu Whole Viron Pandemic Influenza Vaccine | Pandemic Influenza Virus | | | | | | (1) | |
| Split Viron Pandemic Influenza Vaccine | Pandemic Influenza Virus | | | | | | (2) | |
| Panflu.1 | Influenza A H1N1 virus | | | | | | | |
| Mumps Vaccine | Mumps | | | | | (3) | | |
| EV71 Vaccine | EV71 Virus | | | | | | | |
| Pneumococcal Polysaccharide Vaccine | Pneumococcus | | | | | | | |
| Varicella Vaccine | Varicella-zoster virus (Herpes virus 3, Human) | | | | | | | |
| Sabin Inactivated Polio Vaccine | Polio | | | | | | | |
| Pneumococcal Conjugate Vaccine | Pneumococcus | | | | | | | |
| Rubella Vaccine | Rubella | | | | | | | |
| Quadrivalent influenza vaccine | influenza vaccine | | | | | | | |

(1) Our Panflu whole viron pandemic influenza vaccine did not undergo phase III clinical trials because none were required by the relevant authorities in order to receive regulatory approval.

(2) Our Panflu split viron pandemic influenza Vaccine did not undergo phase III clinical trials because none were required by the relevant authorities in order to receive regulatory approval.

(3) Our mumps vaccine did not undergo clinical trials because none were required by the relevant authorities.

- Healive*. In May 2002, we obtained final PRC regulatory approval for the production of Healive, the first inactivated hepatitis A vaccine developed in China. The hepatitis A virus, which is endemic in China and other developing countries, primarily impacts the liver by causing it to swell and preventing it from functioning properly. The disease is highly contagious and can be spread by close personal contact, by consuming contaminated food or by drinking water that has been contaminated by hepatitis A. According to the WHO, as no specific treatment exists for hepatitis A, prevention is the most effective approach against the disease. In February 2008, the PRC government included hepatitis A vaccine into its national immunization program, and announced plans to expand vaccination to newborns nationwide by the end of 2010. According to the NIFDC lot release records, approximately 21.3 million doses of hepatitis A vaccines and 4.6 million doses of inactivated hepatitis A vaccine were approved and released in China for the year ended December 31, 2017. Administered intramuscularly, Healive is available in different doses for use by both adults (1.0 ml per dose) and children (0.5 ml per dose). Our production line to manufacture our hepatitis vaccines, Healive and Bilive, interchangeably has an aggregate combined production capacity of approximately 10 million doses annually. In 2017, 2016 and 2015, we sold approximately 3.8 million, 3.5 million and 4.1 million doses of Healive, which generated approximately \$27 million, \$20.0 million and \$26.8 million in revenues, respectively. Since we launched Healive in 2002, we have sold a total of approximately 56.9 million doses as of December 31, 2017. We are selling Healive in Asia and Latin America.
- Bilive*. In June 2005, we obtained final PRC regulatory approval for the production of Bilive, the first combined inactivated hepatitis A and B vaccine developed and marketed in China. Bilive is a combination vaccine formulated with purified inactivated hepatitis A virus antigen, which we manufacture, and recombinant (yeast) hepatitis B surface antigen, which we source from a third-party supplier. Recipients under China's vaccination program must privately pay for Bilive vaccinations. Bilive is designed for boost immunization or for users in the private-pay market who prefer the convenience of one inoculation rather than two. Similar to hepatitis A, hepatitis B is endemic in China, a major disease worldwide and a serious global public health issue. A substantial percentage of people infected with the hepatitis B virus carry chronic or lifelong infections. The chronically infected are at a high risk of death from cirrhosis of the liver or liver cancer. We are the only supplier in China that produces a combined inactivated hepatitis A and B vaccine, and our market share in China, according to the NIFDC lot release records, was 100% in 2016. Bilive is available in different doses for use in both adults and children. The 1.0 ml dose is for non-immune adults and adolescents 16 years of age and older. The 0.5 ml dose is for pediatric use in non-immune infants, children and adolescents from one year up to and including 15 years of age. The standard Bilive vaccination schedule consists of three doses. The second dose is administered one month after the first dose and the third dose is administered six months after the first dose. Booster vaccinations are recommended five years after the initial immunization. Our production line to manufacture our hepatitis vaccines, Healive and Bilive, interchangeably has an aggregate combined production capacity of approximately 10 million doses annually. In 2017, 2016 and 2015, Bilive generated approximately \$10.4 million, \$0.6 million and \$22.6 million in revenues, respectively.
- Anflu*. In October 2005, we received final approval from the CFDA to produce our Anflu vaccine against influenza. We began marketing Anflu in September 2006. The primary influenza vaccine used worldwide is the split viron vaccine, which contains virus particles disrupted by detergent treatment. The market penetration of the seasonal flu vaccine in China is significantly below that in the developed markets. We are the first Influenza Vaccine Supply, or IVS, taskforce member from a developing country that collaborates with world-class partners in influenza vaccine research. According to the NIFDC lot release records, 26.6 million doses of influenza vaccines were approved and released in China for the year ended December 31, 2017. Our production line to manufacture our flu vaccines, Anflu, Panflu and Panflu.1, interchangeably has an annual production capacity of approximately 8 million doses of Anflu. We sold 2.7 million, 2.0 million and 3.2 million doses of Anflu in 2017, 2016 and 2015, which generated approximately \$13.5 million, \$9.8 million and \$12.7 million in revenues, respectively. Our Anflu products are sold to Asia and Latin America.

- *Panflu*. In April 2008, we were granted a production license for Panflu by the CFDA. Panflu is the first and only approved vaccine available in China against the H5N1 influenza virus. The vaccine is approved for supply within China to the Chinese national vaccine stockpiling program and may not be sold directly to the Chinese commercial market. Panflu is also registered for sale in Hong Kong. Our production line to manufacture our flu vaccines, Anflu, Panflu and Panflu.1, interchangeably has an annual production capacity of approximately 20 million doses of Panflu or 20 million doses of Panflu.1 given the yield of virus strain received from the WHO. We produced Panflu for government reservation since 2008, and we started recognizing revenue in 2010. Our revenue from the sale of Panflu amounted to nil, \$6.4 million and \$3.9 million in 2017, 2016 and 2015, respectively.
- *Panflu.1*. In September 2009, we were granted a production license for Panflu.1 by the CFDA. Panflu.1 is the first approved vaccine in the world against the influenza A H1N1 virus. The outbreaks of influenza A H1N1 was caused by a new virus that had not been seen previously in either human beings or animals. According to the NIFDC lot release records, we ranked number two in market share in China in 2009 and number three in 2010. Our production line to manufacture our flu vaccines, Anflu, Panflu and Panflu.1, interchangeably has an annual production capacity of approximately 20 million doses of Panflu or 20 million doses of Panflu.1. We started to sell Panflu.1 in September 2009. Our revenue from Panflu.1 amounted to approximately \$14 million in 2011, and Panflu.1 is not likely to generate revenues in the foreseeable future. Panflu.1 is also registered for sale in Mexico.
- *Mumps vaccine*. Mumps is a viral disease of the human species caused by mumps virus, which poses a significant threat to human health in the developing countries. According to the NIFDC release records, approximately 237,000 doses of mumps vaccines were approved and released for the year ended December 31, 2017. In September 2012, we were granted a production license for mumps vaccine. We began to sell mumps vaccine in December of 2012 and no revenues were recognized in 2012. Mumps vaccine generated approximately \$1.7 million, \$0.5 million and \$1.5 million in revenues in 2017, 2016 and 2015, respectively.
- *Split viron pandemic influenza vaccine*. Our split viron pandemic influenza vaccine has been developed in conjunction with our whole viron pandemic influenza vaccine. Split viron vaccines are considered to have a better safety profile than whole viron vaccines, both of which are for the governmental stockpiling program. This product has been developed to address the needs of young children, who may be more susceptible to adverse reactions to whole viron pandemic influenza vaccine than to a split viron vaccine. In November 2011, we were granted the production license of split viron pandemic influenza vaccine that is to be used among the teenagers aged from 12 to 17.
- *Inlive*. EV71 causes HFMD among children under ten years old. HFMD is a common and usually mild childhood disease; however, HFMD caused by EV71 has shown a higher incidence of neurologic involvement, and a higher acute fatal incidence. There have been a number of outbreaks of HFMD caused by EV71 in the Asia-Pacific region since 1997 including in China, Malaysia, Singapore, Australia, Vietnam and Taiwan. According to the National Health and Family Planning Commission of China, from 2008 to 2017, more than 18.3 million cases of HFMD were reported, resulting in around 3,650 reported fatalities in China. According to the guidelines for use of inactivated enterovirus type 71 vaccine, EV71 infection caused majority of severe cases and fatalities from 2008 to 2015. There is no identified treatment for enterovirus infections. We started our research and development of the EV71 vaccine in 2008. In December 2009, the CFDA accepted our application to commence human clinical trials and on December 23, 2010, we obtained approval from the CFDA to commence clinical trials. In 2013, we completed all three phases of clinical trials, which showed our EV71 vaccine candidate had a good safety and immunogenicity profile, and had an efficacy rate of 94.6% against HFMD among infants and young children. In February 2014, the phase III clinical trial results of our EV71 vaccine were published online on NEJM, which showed the efficacy of the vaccine against HFMD, or herpangina, was 94.8% among infants and young children. On December 30, 2015, the CFDA issued the new drug certificate and production license for our EV71 vaccine. On January 25, 2016, the CFDA issued the GMP certificate for Inlive. We have eight granted patents relating to the EV71 vaccine in China. Inlive primarily targets children from six months old to three years old, with each child requiring a total of two doses one month apart from another. Inlive generated \$121.3 million and \$35.1 million revenue in 2017 and 2016, respectively.

Our pipeline consists of vaccine candidates in the clinical and pre-clinical development phases in China, as follows:

- *Pneumococcal polysaccharide vaccine*. Pneumococcal polysaccharide vaccine, or PPV, is a vaccine used to prevent streptococcus pneumoniae (pneumococcus) infections, such as pneumonia and septicemia among adults aged 65 or older, adults with serious long-term health problems, smokers, and children older than two years with serious long-term health problems. We filed an application for clinical trials to the CFDA in February 2011 and obtained the approval to commence clinical trials in May 2014. The phase III clinical trial has been completed and we filed an application for a production license in June 2017. The research site inspection and clinical trial site inspection have been completed and registration dossier is being reviewed by CFDA.
- *Pneumococcal conjugate vaccine*. Pneumococcal infection is a leading cause of serious illness in children and adults throughout the world. The disease is caused by a common bacterium, the pneumococcus, which can attack different parts of the human body. According to the WHO, pneumococcal disease is the leading vaccine-preventable killer of children under five years old in the world. At least one million children die of pneumococcal disease every year, most of whom are young children in developing countries. Since the U.S. commenced vaccination programs against this disease, the pneumococcal disease incidence has decreased by 94% in the U.S. Currently, in China, there is only one imported vaccine product against the diseases. No domestic producer has been licensed to supply this vaccine. Our pneumococcal conjugate vaccine will primarily target children two years old or under, who number approximately 32 million in China. We obtained the clinical trials license in January 2015.
- *Rubella vaccine*. Rubella is a disease caused by the rubella virus and an acute infection is usually associated with the symptoms of fever and systemic rash. The clinical trial license was granted in December 2014. Development of this vaccine candidate depends on the progress of developing a measles, mumps and rubella vaccine, or MMR vaccine.
- *Varicella vaccine*. Varicella is a highly contagious infectious disease caused by the varicella-zoster virus (herpesvirus 3, Human). It usually affects children, is spread by direct contact or respiratory route via droplet nuclei and is characterized by the appearance on the skin and mucous membranes of successive crops of lesions that are easily broken and become scabbed. Varicella is relatively benign in children, but may be complicated by pneumonia and encephalitis in adults. According to the NIFDC lot release records, 13.4 million doses of varicella vaccines were approved and released in China for the year ended December 31, 2016. We had completed the pre-clinical studies of a human vaccine against varicella. The clinical trial application was filed with CFDA in January 2013. We obtained the clinical trial license in October 2015. A phase I clinical trial was conducted and completed in 2016 and a phase III trial was completed in 2017. The production license application was filed with CFDA in November 2017. The research site inspection and clinical site inspection have been completed. and the registration dossier is waiting to be reviewed in the queue.
- *Sabin Inactivated Polio vaccine*. Poliomyelitis (polio) is a highly infectious viral disease, which mainly affects young children. The virus is transmitted by person-to-person spread mainly through the fecal-oral route or, less frequently, by a common vehicle (e.g., contaminated water or food) and multiplies in the intestine, from where it can invade the nervous system and can cause paralysis. One in 200 infections leads to irreversible paralysis (usually in the legs). Among those paralyzed, 5-10% die when their breathing muscles become immobilized. In developing countries around the globe including China, oral polio vaccine, or OPV, is widely utilized to eradicate polio. Although OPV is considered safe and effective, in rare instances, the live attenuated vaccine virus in OPV can cause paralysis, resulting in cases of vaccine-associated paralytic polio or circulating vaccine-derived poliovirus. Therefore, to eliminate the risk of such cases, OPV will be phased out from routine immunization programs around the world. According to the Polio Eradication & Endgame Strategic Plan 2013-2018 by WHO, governments should complete, inactivated polio vaccine, or IPV, introduction and OPV withdrawal by 2016, and include IPV and OPV in routine immunization by 2018. OPV will be phased out from routine immunization programs around the world by 2020. Sabin IPV is safer to manufacturers and potentially more affordable as compared to the currently available Salk IPV. The global demand for IPV is increasing as the Global Polio Eradication Initiative has called for IPV to be introduced globally. On April 3, 2014, we entered into a non-exclusive license agreement with The Institute for Translational Vaccinology, or INTRAVACC, a governmental institute working under the Dutch Ministry of Public Health, Welfare and Sports, to develop and commercialize sIPV for distribution in China and other countries. In collaboration with INTRAVACC, we have completed the pre-clinical study and submitted the application for clinical trials to CFDA in October 2014. In November 2015, we obtained a clinical trial license. Phase I/II clinical trials were completed in April 2017, followed by the commencement of a phase III trial, which is expected to be completed in 2018.

- *Quadrivalent influenza vaccine.* Different from the trivalent influenza vaccine, which includes an influenza A H1N1 virus, an influenza A H3N2 virus and one B virus, the quadrivalent influenza vaccine, or QIV, is designed to protect against four different flu viruses; two influenza A viruses and two influenza B viruses, because two very different lineages of B viruses circulate during most seasons. Adding another B virus to the vaccine aims to give broader protection against circulating flu viruses. We initiated the development of a QIV in May 2013. Following the completion of preclinical studies, we applied for the clinical license from the CFDA. The approval to conduct human clinical trial was issued by CFDA in November 2016 and the trial was commenced in January 2018 and is expected to be completed in the first half of 2019.

Research and Development

We have established a leadership position in the research and development of vaccines in China. Since our inception, we have successfully developed and marketed Healive, Bilive, Anflu, Panflu, Panflu.1, mumps vaccine, Inlive and have made significant advances in the prevention of SARS. Please see “— Our Products.” We believe our R&D capabilities provide us with a key competitive advantage. We intend to focus our research and development efforts on developing vaccines for infectious diseases with significant unmet medical needs, as well as the vaccine products with extensive market demand in China and other developing countries.

In 2008, we restructured our R&D team in Beijing to better utilize our scientific and personnel resources. In 2009, we built an R&D center of approximately 13,300 square feet in the campus of our Beijing headquarters to meet our R&D demand. In 2011, we built a lab of 6,778 square feet, which is focused on maintaining quality control of our pipeline products.

In order to achieve our R&D goal, part of our R&D strategy is to focus on in-house development and to establish collaborations with domestic and international partners on technology and virus strains licensing. We have entered into collaborations with a group of leading universities, colleges and research institutes that have strong vaccine research capabilities and proven track records in China. In most cases, we will own the commercial rights to the products that result from our existing R&D strategic collaborations.

The investment in R&D is one of our strategies, which, we believe, will ensure our future growth. Our research and development expenses were \$20.5 million, \$12.6 million and \$9.5 million in 2017, 2016 and 2015, respectively. We have obtained financial support from the PRC government to conduct preclinical and clinical research of vaccines for government-sponsored programs.

Sales and Marketing

Our sales strategy is to maintain our market share and competitive advantage in the private vaccine sales market in China while building on this strength to expand market share in the government-paid market.

The overall vaccine market improved in 2017, following the impact of negative publicity regarding the incident where vaccines were illegally sold and distributed in Shandong province and other provinces around China in 2016. Total sales of our regular products increased by 164.0% year over year.

We primarily rely on our own sales force to sell our products directly to CDCs in the private market before 2017. During 2017, our sales model was changed from direct sales by in-house team to a collaborative model between our sales team and third party promoting companies. These change of business model will combine the advantages of wider coverage via the promoting companies with our internal scientific expertise to provide better services to our customers. As of December 31, 2017, our in-house sales and marketing team consisted of 66 staff members assigned to five regions covering 31 provinces and four municipal cities throughout China. And we have entered into collaboration with 44 third party promotion companies, who helped promote business among CDCs. We still directly enter into sales agreements with CDCs each time a CDC places a purchase order. Pursuant to the sales agreements, CDCs agree not to re-sell our products to regions outside the territory the pertinent CDC covers administratively. Our sales team still maintains stable relationships with our customers by providing them with technical supports and trainings in collaboration with promoting companies. We believe these efforts contributed to our reputation for quality and brand awareness in the Chinese vaccine market.

We intend to establish our presence, increase our sales to international markets and enhance awareness of our products outside of China. Our products are registered in several Asian countries as well as Latin American countries. As of December 31, 2017, we had already exported some of our products to 11 countries. In order to speed up the globalization progress, as well as strengthening our reputation for quality, we obtained WHO prequalification in December 2017 for our hepatitis A vaccine, or Healive. We will explore the globalization of our portfolio and develop products targeting other potential international markets where we believe we can be successful.

Seasonality

Our business is highly seasonal. For example, the influenza season generally runs from November through March of the next year, and the largest percentage of influenza vaccinations is administered between September and November of each year. As a result, we expect to realize most of our annual revenues from Anflu during this period. We expect this seasonality in our business to contribute to significant quarterly fluctuations in our operating results. In the first quarter, our strong winter-season sales are usually offset by the slow-down of business during the Chinese New Year holiday season that effectively lasts more than half a month. During this holiday season, many businesses in China, including CDCs and most departments in hospitals, are either closed or substantially reduce the level of their activities. Please see “Item 3. Key Information — D. Risk Factors — Risks Related to Our Company — Our business is highly seasonal. This seasonality will contribute to our operating results fluctuating considerably throughout the year.”

Suppliers

We obtain the raw materials from local and overseas suppliers. We generally maintain at least two suppliers for each key raw material, with the exception of hepatitis B antigens we use for Bilive production. We source hepatitis B antigens entirely from Beijing Tiantan. Please see “Item 3. Key Information — D. Risk Factors — Risks Related to Our Company — If any of our third-party suppliers or manufacturers cannot adequately meet our needs, our business could be harmed.” Raw materials generally are in good supply and the prices we pay for them have remained stable. We target to maintain our gross margin in the event of rising raw materials costs by improving our production processes and technical methods.

Manufacturing, Safety and Quality Assurance

We have three manufacturing bases located in the Haidian and Changping Districts of Beijing and Dalian City of Liaoning province.

We have two upstream production facilities in Haidian District, Beijing for commercialized products. Our Healive and Bilive share the same production line, which has an aggregate annual capacity of 10 million doses. Our Anflu production line has an annual capacity of 8 million doses, which can also be used to produce 20 million doses of Panflu or Panflu.1 annually.

Our Healive, Bilive and Anflu production facilities received their GMP certificates initially in March 2002, June 2005 and October 2005, respectively, and renewed their GMP certificates for another five years in 2008, 2010 and 2010, respectively. The upstream production plants for our hepatitis vaccines and flu vaccines in Haidian District have passed the new GMP certification and obtained the new GMP certificate on April 17, 2013, which was renewed on April 13, 2018. Our upstream production line for PPV, with annual production capacity of 5 million doses, was built in Haidian site in 2014. As described above, a representative of Sinobioway Medicine and dozens of unidentified individuals forcibly entered Sinovac Beijing’s corporate offices and cut power to our Shangdi site. Due to the actions of the representative of Sinobioway Medicine, Sinovac Beijing was forced to destroy the affected products and temporarily suspended production at the impacted facility in order to maintain product safety.

We have built a new production site in Changping District, Beijing, which consists of a new filling and packaging line that complies with the new PRC GMP standards, EV71 production facilities and a warehouse. The EV71 vaccine production line has a designed annual capacity of 20 million doses and was granted the GMP certificate in January 2016. Our upstream production facilities of Sabin IPV were built in Changping in 2017 with expected annual production capacity of 20 million doses.

Our production site in Sinovac Dalian focuses on the research, development, manufacturing and commercialization of live-attenuated vaccines, such as varicella, mumps and combination vaccines containing measles, mumps, rubella, and/or varicella. Sinovac Dalian has received its GMP certificate (2010 version) from the CFDA for its mumps vaccine in September 2012 and launched mumps vaccine, its first commercial product, in late 2012. The renewed GMP certificate issued by Food and Drug Administration of Liaoning Province was obtained on February 13, 2018, which will remain valid until February 12, 2023. The construction of a production line for the varicella vaccine is being completed.

Each of our subsidiaries has its own quality assurance departments. The quality assurance department of each subsidiary plays a role to supervise the R&D, manufacturing, procurement, quality control, sales and marketing, logistics and plant construction of its own subsidiary under the guidance of relating regulations and guidelines. Regular training or seminars are organized among quality assurance departments of each subsidiary to share and exchange knowledge and experiences.

Sinovac has built a pharmacovigilance system. Pharmacovigilance system includes organization structure, documentation, working procedures and SOPs. The organization structure indicates staff and relevant responsibilities. According to requirements of authorities, we report the severe Adverse Event Following Immunization, or AEFI, in time and regularly. We summarize and analyze safety information coming from post-marketing surveillance, phase IV clinical trials, safety studies and literatures, and to submit the Periodic Safety Update Reports to authorities regularly. Meanwhile, we are also required to assist authorities to investigate on the AEFIs and provide information as required.

Collaborations

In September 2015, Sinovac Dalian entered into a technology transfer and supply agreement with GSK, to use GSK's measles seeds to develop combination vaccines containing measles for the China market. Under this agreement, GSK agreed to transfer its measles seeds, and provide reasonable assistance and relevant technical materials to Sinovac Dalian for developing and producing combination vaccines containing measles. The Company made a payment of \$87,000 for purchasing measles seeds from GSK during the year ended December 31, 2017.

On April 3, 2014, we entered into a non-exclusive license agreement with INTRAVACC, a governmental institute working under the Dutch Ministry of Public Health, Welfare and Sports, to develop and commercialize sIPV for distribution in China and other countries. We expect to develop and commercialize the vaccine in China, as well as seeking regulatory approval in other countries. The agreement has a term of 50 years. Please see "— Our Products."

We agreed to pay INTRAVACC license fee of up to \$2,406 million (€1.5 million) net of PRC withholding tax, including an entrance fee and milestone payments upon achieving specific milestones. We also agreed to pay royalty payments in a single digit percentage of net sales generated worldwide from the product or products developed under the license agreement. We recorded an entrance fee of \$0.7 million (€0.5 million) excluding PRC withholding tax for the year ended December 31, 2014 as research and development expense. We also recorded \$0.1 million (€0.1 million) for payment made to INTRAVACC for use of sIPV viral seeds in research and development expense for the year ended December 31, 2014. There was no expense incurred or paid to INTRAVACC for the year ended December 31, 2017 and 2015. We recorded a milestone fee of \$0.6 million (€0.5 million) for the year ended December 31, 2016 as research and development expense.

We licensed from MedImmune, LLC, or MedImmune, certain rights to use patented reverse genetics technology pertaining to a virus strain used for the production of Panflu (H5N1). We have agreed to pay an upfront license fee and to pay milestone payments of up to an aggregate of \$9.9 million upon the achievement of certain amount of cumulative net sales of licensed products in China (including Hong Kong and Macau), as well as royalty payments in single digits of net sales of the licensed products in China (including Hong Kong and Macau). On August 15, 2012, we entered into amendment agreements with MedImmune in respect of four of our patent license agreements with MedImmune to, among other things, extend the effectiveness of each agreement to reflect revised termination dates between December 2015 and May 2021. We accrued license fee and royalties of \$3.4 million at the end of 2011 which were paid in 2012. We did not make any royalty payment in 2013 but made a \$1.0 million royalty payment in May 2014. No royalties were incurred or paid for the year ended December 31, 2015, and we accrued a royalty payment of \$8,000 as of December 31, 2016, which was paid in 2017.

In March 2009, we entered into a technology transfer agreement with Tianjin CanSino Biotechnology Inc. or Tianjin CanSino, a third party company, to develop a 7-valent pneumococcal conjugate vaccine. According to the agreement, Tianjin CanSino will transfer the technology of a pneumococcal vaccine to us. The collaboration term under the technology transfer agreement is from the signing date to eight years after the first sales of the vaccine developed under the technology transfer agreement in the Chinese market. Under this agreement, we agreed to make milestone payments of up to \$3 million and royalty payments ranging from 6% to 10% for the net sales in the Chinese market.

Each of the future milestone payments is subject to certain conditions, including the PRC government approvals at different stages, which are uncertain. We also agreed to make royalty payments for eight years after the first sales of the vaccine developed under the technology transfer agreement in the Chinese market. The sales of the pneumococcal vaccine in the Chinese market are also subject to PRC government approval. Both parties agreed to work together to develop international markets for the products. On November 9, 2009 and December 14, 2011, we entered into two amendments to the technology transfer of another six serotypes and related technology to us for \$0.3 million to develop a 13-valent pneumococcal conjugate vaccine. On January 29, 2015, we entered into the third amendment to the technology transfer agreement dated March 12, 2009 and the first two amendment agreements dated November 17, 2009 and December 24, 2011.

By entering into this third amendment, the technology agreement was revised to be a licensing agreement. The remaining milestone payments under the agreements were reduced. Both Sinovac and Tianjin CanSino are free to develop PCV vaccines or to collaborate with one other company for the same purpose. As of December 31, 2017, we made total milestone payments of \$1.8 million (\$1.0 million under the March 2009 agreement, \$0.2 million under the November 2009 and December 2011 amendments, and \$0.6 million under the January 2015 amendments).

On August 18, 2009, we entered into a patent license agreement with the National Institutes of Health, or NIH, an agency of the United States Public Health Services within the Department of Health and Human Services. NIH has granted us a non-exclusive license to make and use certain of its products. NIH has also granted us the right to use certain associated information for development of its licensed products. The collaboration term under the patent license agreement is from August 18, 2009 to the later of (a) the expiration of all royalty obligations under the licensed rights where such rights exist and (b) eight years after the first commercial sale by us, unless the agreement is terminated earlier per the provisions included therein. We agreed to pay NIH a license issue royalty of \$0.1 million upon execution of the agreement and a non-refundable minimum annual royalty of \$8,000, and royalty payments on net sales ranging from 1.5% to 4.0% depending on the sales territory and the customers. We also agreed to pay NIH benchmark royalties of \$0.3 million upon achieving each benchmark as specified in the patent license agreement, including completion of clinical trials, regulatory approval for marketing, and achievement of commercial sales.

Competition

The pharmaceutical, biopharmaceutical and biotechnology industries both within China and globally are intensely competitive and are characterized by rapid and significant technological progress, and our operating environment is increasingly competitive. In 2010, the CFDA increased the quality standard of some vaccine products by issuing a new version of Pharmacopeia. As a result, some vaccine products manufactured by multinational companies could no longer be sold in China. According to the CFDA, there are approximately 40 vaccine companies in China, of which we believe approximately ten are our direct competitors.

Even with the advent of private medical and healthcare insurance programs in China and the government vaccine purchase program's expanded vaccine list, most Chinese citizens must pay for their own vaccines because these insurance programs do not typically cover vaccines and the government vaccine purchase program covers only infants and young children. We believe the consumer market is health conscious yet price sensitive and accordingly would favor our products over both cheaper but not enough high quality vaccines provided by local manufacturers and comparable quality but more expensive vaccines manufactured by international competitors. Our competitors, both domestic and international, include large integrated multinational pharmaceutical, domestic state-owned entities and domestic private companies that currently engage in, have engaged in or may engage in efforts related to the discovery and development of new biopharmaceuticals and vaccines. Many of these entities have substantially greater research and development capabilities and financial, scientific, manufacturing, marketing and sales resources than we do, as well as more experience in research and development, clinical trials, regulatory matters, manufacturing, marketing and sales, although these advantages are not comprehensive.

Multiple vaccine products have been approved for sale worldwide. Many of these vaccine products are marketed by our major competitors and are in the areas of hepatitis A, hepatitis B, influenza and EV71. Specifically, with respect to the inactivated hepatitis A vaccine, we consider Kunming Institute of Biological Product, Sanofi Pasteur and Merck Sharp & Dohme Corp. as key competitors in the China market, and GlaxoSmithKline Biologicals and Merck Sharp & Dohme Corp. for the markets outside of China.

In China, according to the batch release numbers published by NIFDC, over 75% of hepatitis A vaccines released in China are live attenuated vaccine, another type of hepatitis A vaccine compared to inactivated version, which is the biggest competitor for inactivated hepatitis A vaccine. The live attenuated hepatitis A vaccine manufacturers include Kunming Institute of Biological Product, Pukang Biological Co., Ltd., Changchun Institute of Biological Products and Changchun Changsheng Life Sciences Ltd. With respect to the hepatitis A and B vaccines, we are the only company to supply hepatitis A and B vaccine in China.

With respect to the influenza vaccines, in China, we consider Hualan Biological Engineering Inc., Changchun Institute of Biological Products, Sanofi Pasteur S.A., Changchun Changsheng Life Sciences Ltd., Aleph Biological Co., Ltd. (Dalian Yalifeng) and multinational companies including GlaxoSmithKline Biologicals, Sanofi Pasteur S.A. as our major competitors for the market outside of China. With respect to the EV71 vaccines, we considered Kunming Institute of Biological Product and China National Biotec Group Co., Ltd. as our key competitors in China as well as outside of China.

We believe we enjoy a number of advantages over our PRC domestic and multinational competitors. Generally, we believe that the principal competitive factors in the markets for our products and product candidates include:

- safety and efficacy profile;
- brand reputation;
- product supply; and
- after-sales service.

Intellectual Property and Proprietary Technology

Protection of our intellectual property and proprietary technology is important for our business. We rely primarily on a combination of trademark, patent and trade secret protection laws in China and other jurisdictions, as well as employee and third-party confidentiality agreements to safeguard our intellectual property, know-how and our brand. Our ability to protect and use our intellectual property rights in the development and commercialization of our technologies and products, operate without infringing the proprietary rights of others and prevent others from infringing our proprietary rights is crucial to our continued success. We will be able to protect our products and technologies from unauthorized use by third parties only to the extent that they are covered by valid and enforceable patents, trademarks or copyrights, or are effectively maintained as trade secrets, know-how or other proprietary information.

We have a total of 51 issued patents and a number of pending patent applications relating to our vaccines in China. Our hepatitis A vaccine and seasonal influenza vaccine and EV71 vaccine have five, three and eight issued patents for protection, respectively.

With respect to, among other things, proprietary know-how that is not patentable and processes for which patents are difficult to enforce, we rely on trade secret protection and confidentiality agreements to safeguard our interests. We believe that many elements of our vaccine products, clinical trial data and manufacturing processes involve proprietary know-how, technology or data that are not covered by patents or patent applications. We have taken appropriate security measures to protect these elements. We have entered into confidentiality agreements (which include, in the case of employees, non-competition provisions) with many of our employees, consultants, outside scientific collaborators, sponsored researchers and other advisors. These agreements provide that all confidential information developed or made known to the individual during the course of the individual's relationship with us is to be kept confidential and not disclosed to third parties except in specific circumstances. In the case of our employees, the agreements provide that all of the technology conceived by the individual during the course of employment is our exclusive property and require our employees to assign to us all of their inventions, designs and technologies they develop during their terms of employment with us and cooperate with us to secure patent protection for these inventions if we wish to pursue such protection.

We have relied on administrative protection afforded new drugs through the monitoring period provided by the CFDA in the past. During the monitoring period, third party applications for manufacturing or importing the same drug are not accepted by the CFDA. The administrative protection for Healive expired in December 2007 and Bilive expired in January 2008. The administrative protection was no longer implemented in China. Instead, CFDA implements a new drug monitoring period starting from the issuance of production license, aiming to collect safety data for further evaluation on new products of this kind commercialized in China. Our EV71 vaccine was granted a five-year new drug monitoring period, during which no other company is able to be approved to enter into a human clinical study of this kind of vaccine except the three products from Kunming, CNBG and Sinovac approved in China. This monitoring period of our EV71 vaccine will expire in December 2020.

We maintain 20 registered trademarks in China, including (i) Sinovac, (ii) Sinovac's Chinese name and its logo, (iii) Healive, its Chinese name and its logo, (iv) Bilive and its Chinese name, (v) Anflu and its Chinese name, (vi) Panflu, its Chinese name and its logo, (vii) PANFLU.1 and its Chinese name, (viii) Chinese name of Inlive and (ix) EV71Vac and EntV71. We have registered "Sinovac" trademark in Canada, Malaysia, Philippines and the United States. We have registered "Sinovac" as trademarks under the "Madrid international trademark registration system," which can be used in the member countries of Madrid Union, including France, United Kingdom and Germany. Since the "Sinovac" trademark certificates of Columbia, India and Thailand have already expired, we now deal with their renewal procedures.

We currently use "科兴" (Kexing) as part of Sinovac Beijing's Chinese trade name in the PRC. We also use "科兴" (Kexing) as part of the Chinese trade name of Sinovac Dalian in the PRC. Shenzhen Kexing currently owns the "科兴" trademark registered in China for Class 5 (Pharmaceuticals) under the International Classification of Goods and Services. To protect our interest in using "科兴" in our trade name, we applied to register "科兴" in China for Class 42 (Scientific & Technological Services & Research) in 2006 and the PRC Trademark Office of the State Administration for Industry and Commerce approved our application in 2010. The "科兴" trademark owned by Shenzhen Kexing has not been identified as "Well-known Trademark" by the relevant PRC authorities since we first started using "科兴" in the trade name of Sinovac Beijing in 2001. If the "科兴" trademark owned by Shenzhen Kexing is ever officially identified as a "Well-Known trademark," however, we may be subject to trademark infringement claim for the use of "科兴" in our trade name.

Although the trademark application and the trade name approval systems are administered separately in China, that we may lose our ability to use the "科兴" trademark in our trade name due to a successful trademark infringement claim, which may adversely affect our ability to maintain and protect our brands, cause us to incur litigation costs and divert resources and management attention. As our brand name is becoming more recognized in the vaccine market, we are working to maintain, increase and enforce our rights in our trademark portfolio, the protection of which is important to our reputation and branding.

We have registered our domain names, including www.sinovac.com.cn and www.sinovac.com, with the China Internet Network Information Center.

Insurance

We maintain property insurance coverage with an annual aggregate insured amount of approximately RMB697.6 million (\$107.2 million) to cover our property and facilities from claims arising from fire, earthquake, flood and a wide range of other natural disasters. Our worldwide product liability insurance of Healive, Bilive, Anflu, Panflu and Inlive worldwide from April 2017 to April 2018 is limited. In addition, we do not carry liability insurance to cover liability claims that may arise from the incidents relating to the clinical trials of our vaccine products. Our insurance coverage may not be sufficient to cover any claim for product liability or damage to our fixed assets.

We do not maintain any business interruption insurance. We are carrying worldwide product liability insurance for Healive, Bilive, Anflu, Panflu and Inlive (excluding U.S. and Europe) from April 2017 to April 2018. We are negotiating with the insurance providers for a renewal of our product liabilities insurance policies. See "Item 3. Key Information — D. Risk Factors — Risks Related to Our Company — We could be subject to costly and time-consuming product liability actions and, because our insurance coverage is limited, our exposure to such claims could cause significant financial burden."

Regulatory Framework of the Pharmaceutical Industry in the PRC

The testing, approval, manufacturing, labeling, advertising and marketing, post-approval safety reporting, and export of our vaccine products or product candidates are extensively regulated by governmental authorities in the PRC and other countries.

In the PRC, the CFDA regulates and supervises biopharmaceutical products under the Pharmaceutical Administration Law, the Implementing Regulations on Pharmaceutical Administration Law, the Administration of Registration of Pharmaceuticals Procedures, and other relevant rules and regulations which are applicable to manufacturers in general. Every step of our biopharmaceutical production is subject to the requirements on the manufacture and sale of pharmaceutical products as provided by these laws and regulations, including but not limited to, the standards of clinical trial, declaration, approval and transfer of new medicine registrations, applicable industry standards of manufacturing, distribution, packaging, advertising and pricing.

Pre-clinical Studies. Pre-clinical studies include in-vitro laboratory evaluation of the product candidate, as well as in-vivo animal studies to assess the potential safety and efficacy of the product candidate. Pre-clinical studies must be conducted in compliance with Good Laboratory Practice for Non-clinical Studies of Pharmaceuticals. With respect to vaccines, the pre-clinical studies should also comply with Technical Guidance for Pre-clinical Studies on Preventive Vaccines. We must submit a file package for investigational new drug application, or IND, to the Centers for Drug Evaluation. The files should include pharmaceutical research, pharmacology and toxicology research, together with the records of manufacturing and testing and the sample of product candidate. We cannot commence clinical trials until we obtain the approval of IND. We cannot assure that submission of an IND will result in the Centers for Drug Evaluation allowing clinical trials to begin, after these trials commence, issues could arise that result in the suspension or termination of such clinical trials.

Clinical trials. Clinical trials involve the administration of the product candidate to healthy volunteers or vaccinees under the supervision of principal investigators, who are generally physicians or an independent third party not employed by us or under our control. Clinical trials typically are conducted in three sequential phases, but the phases may overlap or be combined. In Phase I, the initial introduction of the drug into human subjects, the drug is usually tested for safety (adverse effects), dosage tolerance, and pharmacologic action. Phase II usually involves studies in a limited vaccinee population to evaluate preliminarily the efficacy of the drug for specific, targeted conditions and to determine dosage tolerance and appropriate dosage and to identify possible adverse effects and safety risks. Phase III trials generally further evaluate clinical efficacy and test further for safety within an expanded vaccinee population. Clinical trials have to be conducted in compliance with the Good Clinical Trial Practice of Pharmaceuticals.

With respect to vaccines, we also have to comply with the CFDA's Requirements on Application for Clinical Trial of New Preventive Biological Products. The sample vaccine products must be tested by the NIFDC before they may be used in the clinical trials. We or the CFDA may suspend clinical trials at any time on various grounds, including a finding that subjects are being exposed to an unacceptable health risk.

After three phases of clinical trials, we apply for New Drug Application, or NDA. We submit to the Centers for Drug Evaluation the NDA file package, which includes a clinical trial research report, pharmaceutical research data, and records of manufacturing and testing of three batches of products, to apply for a new drug certificate and/ or production license. For vaccines, we have to comply with the CFDA's Guidelines for Clinical Trial Report on Vaccines.

New Drug Certificate. The Centers for Drug Evaluation will conduct a preliminary examination of our application for a new drug certificate. Once it decides to accept our application based upon such preliminary examination, the Centers for Drug Evaluation will begin technical review, and give their technical opinion to CFDA. At the meantime, according to the requirement of technical review, the Centers for Drug Evaluation can ask for an on-site examination on the circumstances of our clinical trials and pharmaceutical research. The CFDA will decide whether or not to issue a new drug certificate to us. We consider obtaining the new drug certificate for our product candidates a significant milestone in our business.

Production Permit. Simultaneously with the application of new drug certificate, we also apply to CFDA for a production license to manufacture the new drug to be approved by the CFDA. The production license application will be examined with similar stage procedure as for the new drug certificate, first by the Center for Drug Evaluation, and the CFDA the last. After the Center for Drug Evaluation accepts the application, the Center for Drug Evaluation will review the application files and give technical opinion. If the Center for Drug Evaluation is satisfied with our application materials, it will notify us to apply for the on-site production inspection within six months after being so notified.

The Center for Food and Drug Inspection will conduct an on-site inspection on our production procedures within 30 days after receipt of our application and take samples from three batches of our products, and the NIFDC will test the selected samples and later submit its testing reports to the Centers for Drug Evaluation. The Center for Food and Drug Inspection must submit the on-site production inspection report to Center for Drug Evaluation. The Centers for Drug Evaluation will form a comprehensive opinion based upon the technical review and evaluation opinion, the on-site production inspection report and the testing results of the samples, and submit its opinion and relevant materials to the CFDA. The CFDA will decide whether or not to issue the production permit to us. If the product approval and production approval both meet the criteria, the CFDA will issue the production permit together with the new Drug certificate at the same time. The production permit is valid for a term of five years and must be renewed before its expiration. During the renewal process, our production facilities will be re-evaluated by the appropriate governmental authorities and must comply with effective standards and regulations.

Under certain circumstances, for instance, where drugs are developed to cure a disease without effective therapeutic methods, the CFDA provides a special proceeding for its review of the new drug certificate application and production permit application relating to such drugs.

The CFDA will specify a monitoring period ranging from three to five years when approving the first production permit for most new drugs. During this monitoring period, the manufacturers holding the new drug certificates must regularly report, among other things, the production process, efficacy, stability and side effects of the new drugs involved to the provincial level CFDA. During the same period, the CFDA will not accept any new application for approval of the same drug involved. However, if a third party has filed an application for the same drug and obtained the clinical trial permit before the monitoring period commences, the third party may still obtain a new drug certificate and production permit for the same drug.

We may also be required to conduct clinical trials prior to commencing the manufacturing of pharmaceutical products for which there are published state pharmaceutical standards.

GMP Certificate. After receiving the production permit, we should submit the GMP inspection application to the provincial level CFDA, the provincial level CFDA will arrange for the inspection on our facilities for purposes of GMP inspection. If we pass the GMP inspection, the provincial level CFDA will issue the GMP Certificate. A GMP Certificate is used to approve the quality system, including quality assurance and quality control management, production management, materials and products, qualification and validation, facility and equipment. The CFDA has issued GMP standards for pharmaceutical manufacturers to minimize the risks arising out of the production process of drugs that are not identified or eliminated through testing the final products.

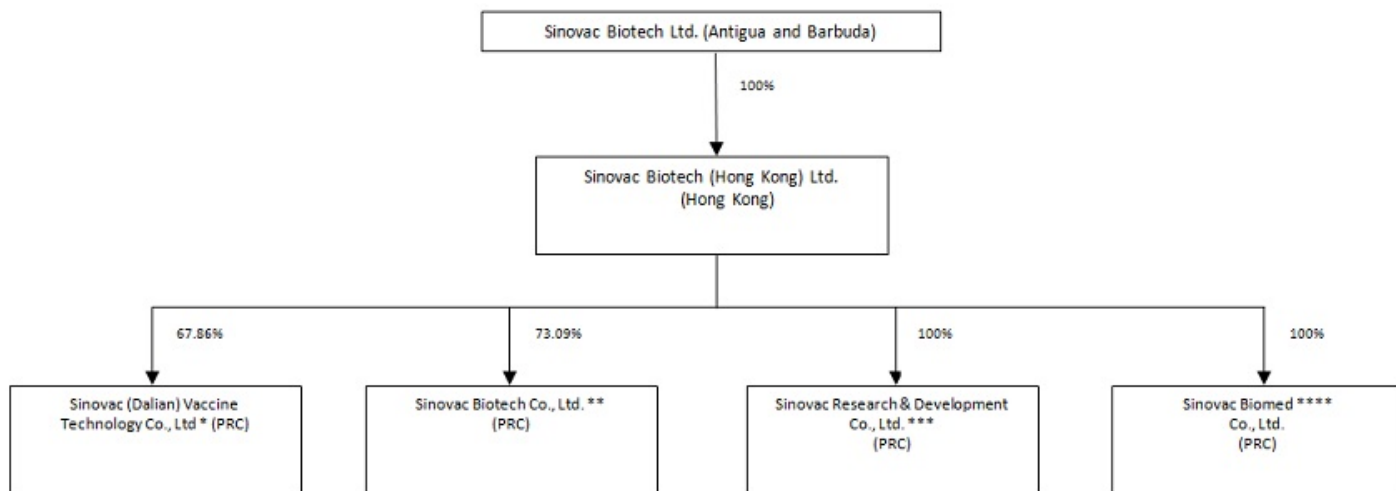
A GMP Certificate is valid for five years and we should apply for a renewal of our GMP Certificate no later than six months prior to the expiration of our GMP Certificate.

We cannot commence the manufacture of a new drug unless and until we have obtained a valid new drug certificate, production permit and GMP Certificate.

Batch Approval. Our vaccine products cannot be distributed in the market before receiving batch approval. After we obtain the GMP certificate, we will start commercial production, after which we need to apply for batch release approval by the NIFDC for the commercial lots. For each batch of products, we will provide samples taken from cold rooms by inspectors, together with manufacturing records, self-testing records and other quality control documents. The NIFDC will review the documents and test the samples and issue a batch approval within approximately two months if our manufacture procedures and the quality of our products meet CFDA standards. With the batch approval, we may distribute the approved batch of vaccines to the market.

C. Organizational Structure

The following diagram illustrates our company's organizational structure, and the place of incorporation, ownership interest and affiliation of each of our subsidiaries as of the date of this report.



* Dalian Jin Gang Group Co., Ltd. owns the remaining 32.14% equity interest in Sinovac Dalian.

** Sinobioway Bio-medicine Co., Ltd., formerly named Xiamen Bioway Group Co., Ltd, owns the remaining 26.91% equity interest in Sinovac Beijing.

*** The former name is Beijing Sinovac Biological Technology Co., Ltd.

**** The former name is Sinovac Zhong Yi Bio-pharmaceutical Co., Ltd.

D. Property, Plants and Equipment

We are headquartered in the Peking University Biological Industry Park (Haidian) in Beijing in a 48,900-square-foot facility, of which approximately 16,700 square feet are used as office space and approximately 32,200 square feet are used for the production plant for Healive and Bilive, where the production equipment for hepatitis vaccines is located. We own the above-described 48,900-square-foot facility in Beijing.

In August 2004, we signed two 20-year leases with SinoBioway Biotech Group Co. Ltd., or SinoBioway, pursuant to which we leased two buildings of approximately 28,000 and 13,300 square feet, respectively, located at the Peking University Biological Park in Beijing. We house our Anflu manufacturing and R&D center in these two buildings. One of the lease agreements was amended on August 12, 2010 to reflect an increase in the lease payment. In June 2007, we signed another 20-year lease with SinoBioway, in order to expand Sinovac Beijing's production facilities in Beijing, pursuant to which we leased one building of approximately 37,000 square feet, located at Peking University Biological Park. Part of our administrative offices and filling facilities are located in this building until 2013. The filling facilities were moved to Changping site in 2013, where we are setting up the commercial production facility for our pneumococcal vaccines.

In September 2010, we entered into an agreement with SinoBioway, under which we lease a space of 6,778 square feet. The lease term is five years and we used it for our research and development function. On April 8, 2013, we entered into three supplemental agreements with SinoBioway, under which the expiration date of each of the four operating lease agreements was extended to April 7, 2033.

We have three production lines located in the Peking University Biological Park (Haidian). Our production line to manufacture our hepatitis vaccines, Healive and Bilive, interchangeably has an aggregate combined production capacity of approximately 10 million doses annually. Our production line to manufacture our flu vaccines, Anflu, Panflu and Panflu.1, interchangeably has an annual production capacity of approximately eight million doses of Anflu (northern hemisphere), or the equivalent of 20 million doses of Panflu or 20 million doses of Panflu.1.

We have also built PPV production line at the Haidian site with designed annual capacity of five million doses per year. In May 2013, our filling and packaging line in Changping site was granted the GMP certificate for the first time, after which we moved the filling and packaging activities to our Changping site. In July 2016, we started to build our sIPV plant for bulk production on our Changping site. The expected capacity is approximately 20 million doses. The five-year GMP renewal on Changping site was successfully completed in April 13, 2018.

In February 2010, we acquired a right to use approximately 312,400 square feet of land located in Changping District, Beijing, or Changping Site, with five buildings with a total built-out area of 32,322 square meters (approximately 347,900 square feet) on 29,021 square meters (for a total consideration of approximately RMB123.6 million (\$19.1 million)). We have made all required payments by December 31, 2012. We have built a new filling and packaging line, EV71 production facilities and a warehouse on the Changping site. The new filling and packaging line and warehouse commenced operation in May 2013 and December 2010, respectively. The EV71 vaccine production line has a designed annual capacity of 20 million doses and was granted the new GMP certificate in January 2016. As described above, a representative of Sinobioway Medicine and dozens of unidentified individuals forcibly entered Sinovac Beijing's corporate offices and cut power to our Shangdi site. Due to the actions of the representative of Sinobioway Medicine, Sinovac Beijing was forced to destroy the affected products and temporarily decided to stop production at the impacted facility in order to maintain product safety.

In November 2009, we entered into an agreement with Dalian Jin Gang Group to establish Sinovac Dalian. In January 2010, we established Sinovac Dalian which focuses on the research, development, manufacturing and commercialization of live-attenuated vaccines, such as varicella, mumps and rubella vaccines for human use. Sinovac Dalian has seven existing buildings with a total built-out area of 20,000 square meters (approximately 215,280 square feet) on 95,685 square meters (approximately 1,030,000 square feet) of land, located at DD Port, Economic and Technical Development Zone, Dalian City, Liaoning province. The construction of a varicella vaccine production plant within the existing building in Sinovac Dalian with total area of 4,458 square meters is underway. The expected annual capacity is five million doses. Sinovac Dalian received its GMP certificate (2010 version) from the CFDA for its mumps vaccine in September 2012.

ITEM 4A. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with our consolidated financial statements and the related notes included elsewhere in this annual report on Form 20-F. This discussion may contain forward-looking statements based upon current expectations that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under "Item 3. Key Information — D. Risk Factors" or in other parts of this annual report on Form 20-F.

A. Operating Results

Overview

We are a fully integrated, China-based biopharmaceutical company that focuses on the research, development, manufacturing and commercialization of vaccines against infectious diseases. We have successfully developed a portfolio of products, consisting of vaccines against hepatitis A, hepatitis B, enterovirus type 71, influenza viruses and mumps. The following table sets forth certain information on our commercialized products.

| Products | Date of Approval | Number of Doses Sold | | |
|-------------------------|------------------|----------------------|-------------|-------------|
| | | 2017 | 2016 | 2015 |
| Healive | May 2002 | 3.8 million | 3.5 million | 4.1 million |
| Bilive | June 2005 | 0.6 million | 0.4 million | 2.3 million |
| Anflu | October 2005 | 2.7 million | 2.0 million | 3.2 million |
| Inlive | January 2016 | 4.7 million | 1.5 million | nil |
| Panflu ⁽¹⁾ | April 2008 | nil | 1.9 million | 1.1 million |
| Panflu.1 ⁽¹⁾ | September 2009 | nil | nil | nil |
| Mumps | September 2012 | 0.3 million | 0.3 million | 1.2 million |

(1) We sold all of our Panflu and Panflu.1 products to the PRC government. Our sales of Panflu and Panflu.1 depend on the completion of government audit on our fulfillment to the stockpiling order. In 2016, 1.9 million doses of Panflu products manufactured for the government stockpiling order were not used and expired, allowing us to recognize sales revenue. Sales of Panflu generated revenues of \$6.4 million in 2016.

Our pipeline consists of various vaccine candidates in the clinical trial development phases and production application phase in China. We obtained the approvals to conduct clinical trials of PPV, pneumococcal conjugate vaccine, sIPV, varicella vaccine and quadrivalent flu vaccine in May 2014, January 2015 and November 2015, October 2015 and November 2016, respectively.

Our Proprietary Rights

Healive was co-developed by Tangshan Yian and the NIFDC. In April 2001, Tangshan Yian contributed its proprietary rights to Healive to Sinovac Beijing as its capital contribution to Sinovac Beijing. In 2002, the NIFDC, Tangshan Yian and Sinovac Beijing agreed that Sinovac Beijing owned the right to market and sell Healive, and that Sinovac Beijing was required to pay the NIFDC approximately \$1 million for the Healive technology consulting fee that Tangshan had not paid by that time. We obtained Healive's new drug certificate from the CFDA in December 1999, the production license in May 2002, and final PRC regulatory approval for production of Healive in May 2002. Production of Healive commenced in July 2002.

Bilive was initially developed by Tangshan Yian. In March 2002, Tangshan Yian and Beijing Keding entered into an agreement under which Tangshan Yian transferred to Beijing Keding its proprietary rights to Bilive at no cost. In August 2002, Sinovac Beijing acquired the proprietary rights to Bilive from Beijing Keding in consideration of a 10.7% equity interest in Sinovac Beijing and a cash payment of \$18,000. Beijing Keding is owned by Mr. Weidong Yin and three other senior officers of Sinovac Beijing. We received the production license for Bilive from the CFDA in January 2005. In June 2005, we obtained the final PRC regulatory approval for production of Bilive. The cost of the proprietary rights to Bilive was expensed as purchased in-process research and development. Production of Bilive commenced in June 2005.

In March 2003, Sinovac Beijing acquired the proprietary rights to Anflu from Tangshan Yian at the vendor's cost. In November 2004, we completed the acquisition of 100% of the shares of Tangshan Yian. We received final PRC regulatory approval for the production of Anflu in October 2005. The cost of the proprietary rights to Anflu was expensed as purchased in-process research and development.

Sinovac Beijing started to research and develop the H5N1 vaccine in 2004. In 2004, Sinovac Beijing entered into an agreement with the National Institute for Biological Standards and Controls, or NIBSC, an England based laboratory under the WHO, on transferring the H5N1 virus strain. According to the agreement, Sinovac Beijing as the recipient would receive the materials and information from NIBSC. The agreement indicated that Sinovac Beijing can only use received materials and information for academic in-house research purposes and Sinovac Beijing shall negotiate with the owner of reverse genetics technology pertaining to virus strain for any commercial purpose. In April 2008, Sinovac Beijing received a production license for H5N1 from the PRC government and started to produce H5N1 vaccines for the government-stockpiling program in June 2008.

In 2011, we licensed from MedImmune certain rights to use patented reverse genetics technology pertaining to virus strain production for H5N1 influenza vaccine. We have agreed to pay an upfront license fee, milestone payments up to an aggregate of \$9.9 million based upon the achievement of cumulative net sales of licensed products in China (including Hong Kong and Macau), as well as royalty payments in single digit of net sales of the licensed products in China (including Hong Kong and Macau). On August 15, 2012, we entered into amended agreements with MedImmune to, among other things, extend the effectiveness of each agreement to reflect revised termination dates between December 2015 and May 2021. License fee and royalties of \$3.4 million accrued at the end of 2011 was paid in 2012. No payments were made in 2013 and 2015. We made a \$0.9 million royalty payment to MedImmune in 2014.

Amortization expense for these proprietary rights was nil, nil and \$0.4 million in 2017, 2016 and 2015, respectively.

Research and Development Programs

The research and development strategy is developed by management and reviewed and approved by the board of our company. Utilizing the resources and platform of each subsidiary, the R&D team of each subsidiary selects a R&D project and develops a feasibility analysis for review and approval. Once the project is approved, we will track the R&D progress as well as the spending of each project. Each year all the ongoing R&D projects will be reviewed along with the budgeting for the following year.

We also use our research and development resources, including employees and our technology, across multiple product development programs. The table below presents our best estimate of our total research and development costs allocable to our leading research and development programs for the periods indicated. We have allocated direct and indirect costs to each program based on certain assumptions and our review of the status of each program, payroll related expenses and other overhead costs based on estimated usage by each program.

| | Year ended December 31, | | |
|--|-------------------------|------------------|-----------------|
| | 2017 | 2016 | 2015 |
| Research and development programs | | | |
| EV71 vaccine | \$ 306 | \$ 7 | \$ 325 |
| PPV | 3,079 | 3,181 | 2,816 |
| Varicella vaccine | 4,219 | 2,683 | 1,650 |
| sIPV | 9,061 | 3,133 | 1,617 |
| Pneumococcal Conjugate Vaccine | 627 | 461 | 1,155 |
| Mumps vaccine | 141 | 251 | 235 |
| Others | 3,056 | 2,932 | 1,692 |
| Total | \$ 20,489 | \$ 12,648 | \$ 9,490 |

The process of developing, obtaining and maintaining regulatory approvals for new products is lengthy, expensive and uncertain. While the development may take years to complete, the market environment may change from the time when the project is selected, which will have an impact to the expected return of the investment. We anticipate that we will frequently monitor the progress of each key project and determine which of our early stage product candidates is best suited for further development, as well as how much funding to direct to each program, on an on-going basis in response to the scientific and clinical success and commercial potential of each product candidate.

We have obtained the new drug certification, production license and GMP certification for our new core product, the EV71 vaccine. We started the commercial production and sales activities of EV71 vaccine in 2016. We have completed phase III clinical trials for the pneumococcal polysaccharides vaccine and filed an application of production license in 2017. We completed Phase III clinical trials on our varicella in 2017. We also completed Phase II clinical trials of Sabin-IPV vaccine in 2017. In addition, have obtained clinical trial license for the pneumococcal conjugate vaccine.

Government Grants

Deferred government grants represent funding received from the government for research and development, or investment in building or improving production facilities. The amount of deferred government grants as of year-end is net of research and development expenditures or depreciation incurred or those recognized as government grants income. We received government grant that were deferred in the amount of RMB15.6 million (\$2.3 million), RMB5.0 million (\$0.7 million) and RMB1.5 million (\$0.2 million) in 2017, 2016 and 2015, respectively. In addition, we received RMB2.0 million (\$0.3 million) in other government grants and subsidies that were recognized in the statements of comprehensive income (loss) in 2017.

Deferred government grants included RMB3.7 million (\$0.6 million), being the unamortized portion of a grant that we received in 2007 for construction of a pandemic influenza vaccine plant and buildings (RMB5.5 million (\$0.8 million) as of December 31, 2016). RMB1.8 million (\$0.3 million), which will be amortized in 2018, was included in the current portion of deferred government grants and RMB1.9 million (\$0.3 million), which will be amortized after 2018, was included in the non-current portion of deferred government grants. The production facility grant requires us to have the entire facility available to manufacture pandemic influenza vaccines at any given moment upon request by the PRC government. We have fulfilled the conditions attached to the government grant. Government grants relating to these production facilities of \$0.3 million, \$0.3 million and \$0.3 million for the years ended December 31, 2017, 2016 and 2015, respectively, were recorded as a reduction to depreciation expense for those respective years.

Deferred government grants also included RMB1.3 million (\$0.2 million) being the unamortized portion of a grant that we received in 2009 for purchasing equipment for H1N1 vaccine production (RMB2.1 million (\$0.3 million) as of December 31, 2016). RMB0.9 million (\$0.1 million) which will be recognized in 2018 was included in the current portion of deferred government grants and RMB0.4 million (\$57,000) which will be recognized after 2018 was included in the non-current portion of deferred government grants. We have fulfilled the conditions attached to the government grant. Government grant relating to this production facility of \$0.1 million, \$0.1 million and \$0.1 million for the years ended December 31, 2017, 2016 and 2015, respectively, were recorded as a reduction to the related depreciation expense.

Deferred government grants also included RMB0.2 million (\$30,000), being the unamortized portion of a grant that we received in 2013 for purchasing equipment for H5N1 vaccine production. We have fulfilled the conditions attached to the government grant. RMB0.1 million (\$15,000) to be amortized in 2018 was included in the current portion of deferred government grants and RMB0.1 million (\$15,000) which will be amortized after 2017 was included in the non-current portion of deferred government grants. Government grant relating to this production facility of \$15,000, \$15,000 and \$16,000 for the year ended December 31, 2017, 2016 and 2015, respectively, were recorded as a reduction to the related depreciation expense.

Deferred government grants also included RMB14.5 million (\$2.2 million) being the unamortized portion of a grant the Company received in 2015 for equipment purchase and construction of the EV71 vaccine production facility (RMB17.8 million (\$2.6 million) as of December 31, 2016). We have fulfilled the conditions attached to the government grant in 2016. RMB3.3 million (\$0.5 million) which will be amortized in 2018 was included in the current portion of deferred government grants and RMB11.3 million (\$1.7 million) which will be recognized after 2018 was included in the non-current portion of deferred government grants. RMB2.7 million (\$0.4 million) of government grant relating to these production facilities was recorded as a reduction to depreciation expense for the year ended December 31, 2017, and RMB0.3 million (\$80,000) was recorded as government recognized in income for the year ended December 31, 2017.

Deferred government grants also included RMB5.1 million (\$0.8 million) being the unamortized portion of a grant the Company received in 2017 for EV71 phase IV clinical research. As of December 31, 2017, the Company has not fulfilled the conditions attached to the government grant. As the Company does not expect to fulfill the conditions within one year, the grant is recorded as a non-current deferred government grant.

Deferred government grants also included RMB10.0 million (\$1.5 million) being the unamortized portion of a grant the Company received in 2017 for purchasing equipment for sIPV vaccine production. As of December 31, 2017, the Company has not fulfilled the conditions attached to the government grant. As the Company does not expect to fulfill the conditions within one year, the grant is recorded as a non-current deferred government grant.

As of December 31, 2017, conditions attached to a government grant received in 2017 in the amount of RMB0.5 million (\$78,000) for certain production facilities were fulfilled, of which RMB0.1 million (\$19,000) will be amortized in 2018 and RMB0.4 million (\$55,000) will be amortized after 2018, and RMB 30,000 (\$4,000) of government grant relating to these production facilities was recorded as a reduction to depreciation expense for the year ended December 31, 2017. As of December 31, 2017, conditions of four government grants totaling RMB7.1 million (\$1.1 million) have not been fulfilled by us. We expect to fulfill the conditions of the four grants within one year, and these grants totaling RMB7.1 million (\$1.1 million) were included in the current portion of deferred government grants.

Critical Accounting Policies and Estimates

Our consolidated financial information has been prepared in accordance with U.S. GAAP, which requires us to make judgments, estimates and assumptions that affect (1) the reported amounts of our assets and liabilities, (2) the disclosure of our contingent assets and liabilities at the end of each fiscal period and (3) the reported amounts of revenues and expenses during each fiscal period. We continually evaluate these estimates based on our own historical experience, knowledge and assessment of current business and other conditions, our expectations regarding the future based on available information and reasonable assumptions, which together form our basis for making judgments about matters that are not readily apparent from other sources. Since the use of estimates is an integral component of the financial reporting process, our actual results could differ from those estimates. Some of our accounting policies require a higher degree of judgment than others in their application.

When reviewing our financial statements, you should consider (1) our selection of critical accounting policies, (2) the judgment and other uncertainties affecting the application of those policies and (3) the sensitivity of reported results to changes in conditions and assumptions. We believe the following accounting policies involve the most significant judgment and estimates used in the preparation of our financial statements.

Revenue Recognition

Revenue is recognized when persuasive evidence of an arrangement exists, the price is fixed and determinable, delivery has occurred and there is a reasonable assurance of collection of the sales proceeds. We generally obtain purchase authorizations from our customers for a specified amount of products at a specified price and consider delivery to have occurred when the customer takes title of the products. We provide certain customers with a right of return.

Revenue for inactivated hepatitis A, combined inactivated hepatitis A&B, seasonal influenza and EV71 vaccines are recognized when delivery has occurred and we can reasonably estimate return provision for these products. The product return provisions for inactivated hepatitis A vaccine and combined inactivated hepatitis A&B vaccine are estimated based on historical return and exchange data as well as the inventory levels and the remaining shelf lives of the products in the distribution channels. We started to sell EV71 vaccines in 2016. For the year ended December 31, 2016, product return provision for enterovirus 71 vaccine was based on historical return and exchange data of similar products including hepatitis A and combined inactivated hepatitis A&B vaccines, as well as EV71 vaccines' inventory levels and remaining shelf lives in the distribution channels. We review the estimated sales return on an ongoing basis. This review indicated that our marketing and distributing strategy of EV71 vaccines shifted to a manner similar to inactivated hepatitis A vaccine, and no longer distributes the product in a manner similar to combined inactivated hepatitis A&B vaccine. For the year ended December 31, 2017, product return provision for EV71 vaccine was based on historical return and exchange data of hepatitis A, as well as EV71 vaccines' inventory levels and remaining shelf lives in the distribution channels. The change in estimate resulted in an increase to income from continuing operations and net income attributable to shareholders of Sinovac of \$8.1 million and \$5.9 million, respectively. In addition, basic and diluted earnings per share both increased by \$0.10.

As of December 31, 2017, sales return provision for inactivated hepatitis A vaccine, combined inactivated hepatitis A&B vaccine and EV 71 vaccine was \$4.7 million, compared with \$5.0 million as of December 31, 2016. Private pay sales return provision of inactivated hepatitis A vaccine, combined inactivated hepatitis A&B vaccine and EV71 vaccine as a percentage of sales was 3.1% and 10.9% in 2017 and 2016, respectively. We do not accept returns for hepatitis products sold under the EPI and exports. As such, no sales returns are estimated for these sales. Product return provision for seasonal influenza vaccines is estimated based on actual sales returns and expected sales returns up to the end of the flu season because we generally accept returns before the end of the flu season. As of December 31, 2017, sales return provision for seasonal influenza vaccine returns was approximately \$0.3 million, compared with \$0.5 million as of December 31, 2016.

Revenue for mumps vaccines without a right of return provided to customers is recognized when delivery has occurred. Revenue for mumps vaccines with a right of return provided to customers is recognized when payments are collected from customers.

Deferred revenue is generally relating to government stockpiling programs and advances received from customers. For government stockpiling programs of H5N1 vaccines, we generally obtain purchase authorizations from the government for a specified amount of products at a specified price and no rights of return are provided. Revenue is recognized when the government takes delivery of the products. If the products expire prior to delivery, these expired products are recognized as revenue once cash is received and the products have expired and passed government inspection.

Allowance for Doubtful Accounts

We extend unsecured credit to our customers in the ordinary course of business but mitigate the associated risks by performing credit checks and actively pursuing past due accounts. An allowance for doubtful accounts is established and recorded based on management's assessment of the credit history with the customer and current relationships with them.

We also maintain an allowance for doubtful accounts for estimated losses based on our assessment of the collectability of specific customer accounts and the aging of the accounts receivable. We analyze accounts receivable and historical bad debts, customer concentrations, customer solvency, current economic and geographic trends, and changes in customer payment terms and practices when evaluating the adequacy of our current and future allowance. In circumstances where we are aware of a specific customer's inability to meet its financial obligations to us, a specific allowance for bad debt is estimated and recorded, which reduces the recognized receivable to the estimated amount we believe will ultimately be collected. We monitor and analyze the accuracy of the allowance for doubtful accounts estimate by reviewing past collectability and adjust it for future expectations to determine the adequacy of our current and future allowance. Our reserve levels have generally been sufficient to cover credit losses. As of December 31, 2017, the Company provided 100% (December 31, 2016 - 100%) allowance for accounts receivable aged more than four years, approximately 94.6% (December 31, 2016 - 84.8%) allowance for accounts receivable aged between three years and four years, approximately 68.5% (December 31, 2016 - 59.1%) allowance for accounts receivable aged between two years and three years, approximately 15.3% (December 31, 2016 - 20.5%) allowance for accounts receivable aged between one year and two years, and approximately 1.2% (December 31, 2016 - 1.4%) allowance for accounts receivable aged less than one year.

Our allowance for doubtful accounts as of December 31, 2017 was \$4.8 million, compared to \$3.6 million as of December 31, 2016. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. Bad debt provision was \$0.9 million for the year ended December 31, 2017 as compared with a provision of \$1.4 million for the year ended December 31, 2016.

Inventory Provision

We write off all the unsold seasonal influenza vaccines before the end of the flu season at the end of the fiscal year, except for those distributed after the end of the fiscal year. In addition, we estimate an inventory provision for existing Healive, Bilive, Inlive and Mumps products in inventory after considering the sales forecasts, the conditions of the raw material inventory, as well as the expiration dates of these products. The inventory provision in 2017, 2016 and 2015 was \$1.2 million, \$6.4 million and \$1.8 million, respectively.

Impairment of Long-Lived Assets

Long-lived assets, including intangible assets subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of an asset group may not be recoverable from the future undiscounted net cash flows expected to be generated by the asset group. An asset group is identified as assets at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets.

If the asset group is not fully recoverable, an impairment loss would be recognized for the difference between the carrying value of the asset group and its estimated fair value, based on the discounted net future cash flows or other appropriate methods, such as comparable market values. We use estimates and judgments in the impairment tests and the timing and amount of impairment charges could be materially different if different estimates or judgments are utilized. We did not record any impairment charges on long-lived assets in 2017, 2016 and 2015.

Income Tax Valuation Allowance

In 2017, we recorded \$9.3 million of deferred income tax assets based on the difference in timing of certain deductions for income tax and accounting purposes. We evaluate our valuation allowance requirements at each reporting period by reviewing all available evidence, both positive and negative, and considering whether, based on the weight of that evidence, a valuation allowance is needed. When a change in circumstances causes a change in management's judgment about the reliability of deferred tax assets, the impact of the change on the valuation allowance is generally reflected in income from operations. The future realization of the tax benefit of an existing deductible temporary difference ultimately depends on the existence of sufficient taxable income of the appropriate character within the carry forward period available under applicable tax law.

Recently Issued Accounting Standards

In May 2014, the FASB issued ASU No. 2014-09 (“ASU 2014-09”), Revenue from Contracts with Customers (Topic 606), where a single, global revenue recognition model applies to most contracts with customers. Revenue will be recognized in a manner that depicts the transfer of goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled, subject to certain limitations. In August 2015, the FASB issued ASU 2015-14, where the effective date of ASU 2014-09 was extended to annual periods beginning after December 15, 2017. Early adoption is permitted. Subsequent to the issuance of ASU 2014-09, the FASB has issued several accounting standard updates such as ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net), ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, and ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients among others. These ASUs do not change the core principle of the guidance stated in ASU 2014-09, instead these amendments are intended to clarify and improve operability of certain topics included within the revenue standard. These ASUs will have the same effective date and transition requirements as ASU 2014-09. We adopted the new standard since January 1, 2018, using the modified retrospective method. We have completed the assessment and implementation work. Based on the work performed, the adoption of this guidance will not have a material impact on our consolidated financial statements or our internal controls over financial reporting.

In January 2016, the FASB issued ASU No. 2016-01 (“ASU 2016-01”), Financial Instruments. ASU 2016-01 requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or in the accompanying notes to the financial statements. That presentation provides financial statement users with more decision-useful information about an entity’s involvement in financial instruments. The guidance is effective for annual periods beginning after December 15, 2017. Early adoption is permitted. We are currently evaluating the impact on its consolidated financial statements of adopting this standard.

In February 2016, the FASB issued ASU No. 2016-02 (“ASU 2016-02”), Leases. ASU 2016-02 requires recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases. The guidance is effective for annual periods beginning after December 15, 2018. Early adoption is permitted. We are currently evaluating the impact on its consolidated financial statements of adopting this standard.

In November 2016, the FASB issued ASU No. 2016-18 (“ASU 2016-18”), Statement of Cash Flows: Restricted Cash. ASU 2016-18 requires amounts generally described as restricted cash or restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning –of-period and end-of-period total amounts shown on the statement of cash flows. The guidance is effective for annual periods beginning after December 15, 2017. Early adoption is permitted. We adopted ASU 2016-18 on January 1, 2018, and does not expect the adoption of this standard will have a material impact on our consolidated financial statements.

RESULTS OF OPERATIONS

| Consolidated statements of comprehensive income (loss) data | Year ended December 31, | | |
|---|--|------------|------------|
| | 2017 | 2016 | 2015 |
| | (in thousands except share and per share data) | | |
| Sales | \$ 174,346 | \$ 72,431 | \$ 67,414 |
| Cost of sales ⁽¹⁾ | 20,240 | 22,393 | 18,408 |
| Gross profit | 154,106 | 50,038 | 49,006 |
| Operating expenses: | | | |
| Selling, general and administrative expenses ⁽¹⁾ | 87,365 | 41,980 | 37,481 |
| Provision (recovery) for doubtful accounts | 934 | 1,412 | (49) |
| Research and development expenses ⁽¹⁾ | 20,489 | 12,648 | 9,490 |
| Loss on disposal and impairment of property, plant and equipment | 42 | 478 | 26 |
| Government grants recognized in income | (141) | (6,984) | (1,637) |
| Total operating expenses | 108,689 | 49,534 | 45,311 |
| Operating income | 45,417 | 504 | 3,695 |
| Interest and financing expenses | (1,569) | (1,729) | (1,920) |
| Interest income | 1,183 | 731 | 1,155 |
| Other income (expenses) | 13 | 100 | (174) |
| Income (loss) from continuing operations before income taxes | 45,044 | (394) | 2,756 |
| Income tax expenses | (8,339) | (2,664) | (2,985) |
| Income (loss) from continuing operations | 36,705 | (3,058) | (229) |
| Income (loss) from discontinued operations, net of tax nil | - | 2,338 | (728) |
| Net income (loss) | 36,705 | (720) | (957) |
| Less: (income) loss attributable to non-controlling interests | (10,898) | 124 | (459) |
| Net income (loss) attributable to shareholders of Sinovac | 25,807 | (596) | (1,416) |
| Comprehensive income (loss) | 44,803 | (9,563) | (5,342) |
| Less: comprehensive (income) loss attributable to non-controlling interests | (12,089) | 953 | 82 |
| Comprehensive income (loss) attributable to shareholders of Sinovac | \$ 32,714 | \$ (8,610) | \$ (5,260) |

(1) Includes share-based compensation of \$1.0 million, \$2.4 million and \$1.0 million in 2017, 2016 and 2015, respectively.

Sales

Revenues from sales represent: (1) the invoiced value of goods, net of value added taxes, and sales returns. See “Item 5. Operating and Financial Review and Prospects — A. Operating Results — Taxes and incentives.” We recognize revenues at the time when our products are delivered, persuasive evidence of an arrangement exists, the price is fixed and determinable and there is reasonable assurance of collection of the sales proceeds; and (2) the value of goods produced for government stockpiling program. We recognize revenues from the sales of products to the government stockpiling program when cash has been received and the products have expired and passed government inspection or are delivered per government instruction.

Our revenues, growth and results of operations depend on several factors, including the level of acceptance of our products among doctors, hospitals and vaccinees, and our ability to maintain or increase prices for our products at levels that provide favorable margins. The level of acceptance among doctors, hospitals and vaccinees is influenced by the performance, promotion and academic research, and pricing of our products.

We market and sell our vaccine products primarily through provincial and municipal CDCs. We enter into sales agreements with CDCs each time a CDC places a purchase order. Pursuant to these sales agreements, CDCs typically agree not to re-sell our products to regions outside the territory the pertinent CDC covers administratively. Since hepatitis A vaccines were included into government sponsored expanded immunization program in 2007, we have actively participated in the tender and bidding organized by various provincial CDCs. We enter into sales agreements with CDCs when we win a bid.

Pricing

In the private market, we set our price based on our production cost, the price of competitive products and acceptance level of CDC and vaccinees. We also adjust our product price according to changes in the external environment to balance sales volume and gross profit, and ultimately to maximize sales profit margins.

In the public market, the government purchases vaccines for EPI market by issuing government tenders. During the evaluation process, price is a key factor which impacts the result of the tender. Therefore, we need to price our products competitively to win the tenders. We believe that our emphasis on product quality is an advantage and increases our competitiveness.

Cost of sales

Our cost of sales primarily consists of material, direct labor and production overheads. Depreciation of property, plant and equipment attributable to manufacturing activities and license amortization are capitalized as part of inventory, and expensed as cost of sales when product is sold. Cost of goods sold in 2017, 2016 and 2015 amounted to \$20.2 million, \$22.4 million and \$18.4 million, respectively, of which idle capacity amounted to \$2.8 million, \$3.2 million and \$2.2 million, respectively. We produce our products and conduct the final product packaging in-house.

Our production capacity has not been fully utilized. If we successfully commercialized new products and increase sales of existing products, we expect the unit production cost to decrease.

Selling, general and administrative expense

Selling and marketing expenses consist primarily of salaries and related expenses for personnel engaged in sales, marketing and customer support functions and costs associated with marketing activities and shipping. Selling expense in 2017 was \$69.2 million, representing 39.7% of total sales revenue of 2017, which is an 8.5% increase compared to 2016.

General and administrative expense consists primarily of compensation for employees in executive and operational functions, including finance and accounting, business development and human resources. Other significant costs include facilities costs, share-based compensation and professional fees for accounting and legal services.

Research and development expenses

Our research and development expenses consist primarily of:

- salaries and related expenses for personnel;
- fees paid to consultants and clinical research organizations in conjunction with their independent monitoring of our clinical trials and acquiring and evaluating data in conjunction with our clinical trials;
- consulting fees paid to third parties in connection with other aspects of our product development efforts;
- costs of materials used in research and development;
- depreciation of facilities and equipment used to develop our products; and
- technology license fees and milestone payments paid to third parties before a product receives regulatory approval.

We expense both internal and external research and development costs as incurred, other than capital expenditures that have alternative future uses, such as the build-out of our plant, or license fees and milestone payments made to third parties after regulatory approval is received. We expect our research and development costs will continue to be substantial and that they will increase as we advance our current portfolio of product candidates through clinical trials and move other product candidates into pre-clinical and clinical trials.

Taxes and incentives

Sinovac Beijing, Sinovac R&D, Sinovac Dalian and Sinovac Biomed are subject to income taxes in China on their taxable income calculated at a tax rate in accordance with the relevant income tax laws and regulations. Income tax returns filed by our PRC subsidiaries for tax years beginning in 2006 have been subject to examination by tax authorities.

Effective from January 1, 2008, the PRC's statutory income tax rate is 25%. The Company's PRC subsidiaries are subject to income tax at the statutory rate of 25% except for Sinovac Beijing and Sinovac Dalian. Sinovac Beijing, being reconfirmed as a "High and New Technology Enterprise," or HNTE in 2017 for a period of 3 years; Sinovac Dalian, being confirmed as a HNTE in 2017 for a period of 3 years, and accordingly each is subject to a preferential income tax rate of 15% from 2017 to 2019. We determine deferred taxes for each tax-paying entity in each tax jurisdiction. The potential tax benefits arising from the losses incurred by the subsidiaries have been recorded in our financial statements.

We evaluate our valuation allowances requirements at each reporting period by reviewing all available evidence, both positive and negative, and considering whether, based on the weight of that evidence, a valuation allowance is needed. When a change in circumstances causes a change in management's judgment about the realizability of deferred tax assets, the impact of the change on the valuation allowance is generally reflected in income from operations. The future realization of the tax benefit of an existing deductible temporary difference ultimately depends on the existence of sufficient taxable income of the appropriate character within the carry forward period available under applicable tax law.

The valuation allowances relating to the deductible temporary differences and the unused tax losses of Sinovac R&D, Sinovac Dalian and Sinovac Biomed are still required as realization of these elements of the potential tax benefits is still uncertain. Taking the valuation allowances into account, the potential tax benefits arising from the deductible temporary differences and the unused tax losses of Sinovac R&D, Sinovac Dalian and Sinovac Biomed effectively have not been recorded in the financial statements. Tax losses of our PRC subsidiaries in the amount of \$25.5 million (RMB166 million) as of December 31, 2017 will expire from 2018 to 2022, if not utilized.

Year Ended December 31, 2017 Compared to Year Ended December 31, 2016

Sales. Total sales from continuing operations in 2017 increased by 140.7% to \$174.3 million from \$72.4 million in 2016. Excluding revenue recognition of Panflu under the government stockpiling program in 2016 and 2015, regular sales of Healive, Bilive, Anflu, Inlive and mumps vaccine increased by 163.9% to \$174.3 million in 2017 from \$66.0 million in 2016. The growth was mainly contributed by sales of Inlive.

The table below sets forth a breakdown of our sales by product:

| Sales | Year ended December 31, | |
|------------------------|-------------------------|------------------|
| | 2017 | 2016 |
| | (in thousands) | |
| Hepatitis A vaccine | \$ 27,421 | \$ 20,044 |
| Hepatitis A&B vaccine | 10,430 | 552 |
| Influenza vaccines | 13,544 | 9,829 |
| EV71 vaccine | 121,284 | 35,140 |
| Mumps vaccines | 1,667 | 477 |
| Regular sales subtotal | 174,346 | 66,042 |
| H5N1 vaccine | - | 6,389 |
| Total sales | \$ 174,346 | \$ 72,431 |

Gross Profit. Gross profit from continuing operations in 2017 increased by 208.0% to \$154.1 million from \$50.0 million in 2016. Gross margin percentage increased to 88.4% in 2017 from 69.1% in 2016. Excluding the impact of Panflu sales under the government-stockpiling program in 2017 and 2016, gross margin increased to 88.4% in 2017 from 70.0% in 2016. The increase of gross margin was mainly due to higher gross profit on Inlive and lower inventory provision charged to Bilive vaccines in 2017.

Selling, General and Administrative Expenses.

Selling, general and administrative expenses in 2017 increased by 108.1% to \$87.4 million from \$42.0 million in 2016. The increase was mainly due to higher selling expenses incurred on promotion of Inlive and higher professional and consulting fees related to the proposed privatization.

We recorded total share-based compensation of \$1.0 million in 2017, compared to \$2.4 million in 2016. As of December 31, 2017, we had unrecognized compensation costs of \$2.3 million. This unearned component will be recognized over a period of 28 months.

Research and Development Expenses. Research and development expenses in 2017, primarily represented expenditures on the advancement of pipeline vaccines, including pneumococcal vaccines, sIPV and varicella vaccine, increased to \$20.5 million in 2017 from \$12.6 million in 2016.

Interest and Financing Expenses. Interest and financing expense decreased by 9.3% to \$1.6 million in 2017 from \$1.7 million in 2016. There were \$0.3 million and \$37,000 of interest subsidies received in 2017 and 2016, respectively.

Income Tax Expenses. Income tax expense was \$8.3 million in 2017, compared to an income tax expense of \$2.7 million in 2016.

Income (loss) from Continuing Operations. Income from continuing operations was \$36.7 million in 2017, compared to a loss of \$3.1 million in 2016.

Income (loss) from Discontinued Operations. Income from discontinued operations was nil in 2017, compared to an income of \$2.3 million in 2016. The income from discontinued operations in 2016 was a result of completion of the disposal transaction of Tangshan Yian.

Net Income. Net income attributable to shareholders of Sinovac was \$25.8 million in 2017, compared to a net loss of \$0.6 million in 2016.

Year Ended December 31, 2016 Compared to Year Ended December 31, 2015

Sales. Total sales from continuing operations in 2016 increased by 7.4% to \$72.4 million from \$67.4 million in 2015. Excluding revenue recognition of Panflu under the government stockpiling program in 2016 and 2015, regular sales of Healive, Bilive, Anflu, Inlive and mumps vaccine increased by 3.9% to \$66.0 million in 2016 from \$63.6 million in 2015. The growth was mainly contributed by sales of Inlive.

The table below sets forth a breakdown of our sales by product:

| Sales | Year ended December 31, | |
|------------------------|-------------------------|------------------|
| | 2016 | 2015 |
| | (in thousands) | |
| Hepatitis A vaccine | \$ 20,044 | \$ 26,801 |
| Hepatitis A&B vaccine | 552 | 22,615 |
| Influenza vaccines | 9,829 | 12,674 |
| EV71 vaccine | 35,140 | - |
| Mumps vaccines | 477 | 1,472 |
| Regular sales subtotal | 66,042 | 63,562 |
| H5N1 vaccine | 6,389 | 3,852 |
| Total sales | \$ 72,431 | \$ 67,414 |

Gross Profit. Gross profit from continuing operations in 2016 increased by 2.1% to \$50.0 million from \$49.0 million in 2015. Gross margin percentage decreased to 69.1% in 2016 from 72.7% in 2015. Excluding the impact of Panflu sales under the government-stockpiling program in 2016 and 2015, gross margin decreased to 70.0% in 2016 from 73.4% in 2015. The decrease of gross margin was mainly due to higher inventory provision of Bilive vaccines in 2016.

Selling, General and Administrative Expenses.

Selling, general and administrative expenses in 2016 increased by 12.0% to \$42.0 million from \$37.5 million in 2015. The increase was mainly due to higher selling expenses incurred on promotion of EV71 and higher professional and consulting fees related to the proposed privatization.

We recorded total share-based compensation of \$1.5 million in 2016, compared to \$0.6 million in 2015. As of December 31, 2016, we had unrecognized compensation costs of \$3.3 million. This unearned component will be recognized over a period of 40 months.

Research and Development Expenses. Research and development expenses in 2016, primarily represented expenditures on the advancement of pipeline vaccines, including pneumococcal vaccines, sIPV and varicella vaccine, increased to \$12.6 million in 2016 from \$9.5 million in 2015.

Interest and Financing Expenses. Interest and financing expense decreased by 9.9% to \$1.7 million in 2016 from \$1.9 million in 2015. The decrease in interest and financing expense is primarily due to lower interest rates on outstanding loans during 2016 compared to 2015. There were \$37,000 and \$0.1 million of interest subsidies received in 2016 and 2015, respectively.

Income Tax Expenses. Income tax expense was \$2.7 million in 2016, compared to an income tax expense of \$3.0 million in 2015.

Income (loss) from Continuing Operations. Loss from continuing operations was \$3.1 million in 2016, compared to a loss of \$0.2 million in 2015.

Income (loss) from Discontinued Operations. Income from discontinued operations was \$2.3 million in 2016, compared to a loss of \$0.7 million in 2015. The income from discontinued operations in 2016 was a result of completion of the disposal transaction of Tangshan Yian.

Net Loss. Net loss attributable to shareholders of Sinovac was \$0.6 million in 2016, compared to a net loss of \$1.4 million in 2015.

B. Liquidity and Capital Resources

We finance our operations primarily through short-term and long-term borrowings, proceeds from public offerings, capital raised in private placements, cash generated from operations and, to a lesser extent, cash from government research grants. We believe that our current cash and cash equivalents, and anticipated cash flow will be sufficient to meet our anticipated cash needs, including our cash needs for working capital and capital expenditure, for the next 12 months. We may, however, require additional cash due to changing business conditions or other future developments, including any investments or acquisitions we may decide to pursue. If our existing cash is insufficient to meet our requirements, we may seek to sell additional equity securities, debt securities or borrow from banks.

Cash Flows and Working Capital

The following table sets forth a summary of our net cash flows for the periods indicated:

| | Year ended December 31, | | |
|---|-------------------------|-------------|-----------|
| | 2017 | 2016 | 2015 |
| | (in thousands) | | |
| Net cash provided by (used in) operating activities | \$ 61,354 | \$ (15,459) | \$ 4,211 |
| Net cash used in investing activities | (11,896) | (11,776) | (4,515) |
| Net cash provided by (used in) financing activities | (1,342) | 27,784 | (24,196) |
| Effect of exchange rate changes on cash and cash equivalents, including cash classified within current assets held for sale | 3,865 | (2,092) | (1,541) |
| Decrease in cash and cash equivalents, including cash classified within current assets held for sale | 51,981 | (1,543) | (26,041) |
| Less: Net decrease in cash classified within current assets held for sale | - | (143) | (82) |
| Increase (decrease) in cash and cash equivalents | 51,981 | (1,400) | (25,959) |
| Cash and cash equivalents at beginning of period | 62,434 | 63,834 | 89,793 |
| Cash and cash equivalents at end of period | \$ 114,415 | \$ 62,434 | \$ 63,834 |

Operating Activities

Net cash provided by operating activities was \$61.4 million in 2017, compared to net cash used in operating activities of \$15.5 million in 2016. Net cash provided by our operating activities in 2017 resulted primarily from (1) our net income from continuing operations of \$36.7 million, (2) deferred income taxes of \$4.9 million, (3) depreciation of property, plant and equipment and amortization of prepaid land lease payments of \$4.9 million, (4) a decrease of accounts receivable of \$13.5 million and an increase in accounts payables and accrued liabilities of \$33.4 million.

Net cash used in operating activities was \$15.5 million in 2016, compared to net cash provided by operating activities of \$4.2 million in 2015. Net cash used in our operating activities in 2016 resulted primarily from (1) our net loss from continuing operations of \$3.1 million, (2) inventory provision of \$6.4 million, (3) depreciation of property, plant and equipment and amortization of prepaid land lease payments of \$5.3 million, (4) government grants recognized in income of \$7.0 million, and (5) a decrease of deferred revenue of \$5.0 million and an increase in accounts receivable of \$15.1 million.

Investing Activities

Net cash used in investing activities was \$11.9 million in 2017, compared to \$11.8 million in 2016. We invested primarily in the construction of our sIPV production facilities in 2017.

Net cash used in investing activities was \$11.8 million in 2016, compared to \$4.5 million in 2015. We invested more cash in the construction of our PPV and sIPV production facilities in 2016.

Financing Activities

Net cash used in financing activities was \$1.3 million in 2017 compared to net cash provided by financing activities was \$27.8 million in 2016. In 2017, net cash provided by our financing activities included net proceeds of \$1.3 million from issuance of common shares and government funding of \$2.6 million. We also received loan proceeds of \$28.6 million and made loan repayments of \$38.7 million in 2017.

Net cash provided by financing activities was \$27.8 million in 2016 compared to net cash used in financing activities of \$24.2 million in 2015. In 2016, net cash provided by our financing activities included net proceeds of \$0.3 million from issuance of common shares and government funding of \$6.9 million. We also received loan proceeds of \$45.5 million and made loan repayments of \$24.9 million in 2016.

Accounts Receivable

Our total accounts receivable, including other receivables, increased by \$16.4 million from \$49.8 million as of December 31, 2016 to \$66.2 million as of December 31, 2017. Our average accounts receivable turnover time in 2017 was 127 days, as compared to 256 days in 2016.

Our maximum exposure to credit risk at the balance sheet dates relating to accounts receivables is summarized as follows:

| | Year ended December 31, | |
|---|--------------------------------|------------------|
| | 2017 | 2016 |
| | (in thousands) | |
| Aging within one year, net of allowance for doubtful accounts | \$ 58,157 | \$ 45,340 |
| Aging greater than one year, net of allowance for doubtful accounts | 6,512 | 3,118 |
| Total trade receivable — net | <u>\$ 64,669</u> | <u>\$ 48,458</u> |

Borrowings

As of December 31, 2017, we had \$18.2 million in short-term bank loans, offset by \$114.4 million in cash and cash equivalents, resulting in a liquid assets balance of \$96.3 million, compared with \$31.1 million at the end of December 31, 2016. The following tables summarize our short-term and long-term bank borrowings as of December 31, 2017:

| Type | Amount | Annual Interest Rate | Interest Payment | Maturity Date | Purpose |
|--------------------------------|---------------------------------|----------------------|------------------|------------------|------------------------------------|
| Bank loan from Bank of Beijing | RMB4.9 million (\$0.8 million) | 4.57% | quarterly | August 29, 2018 | operation |
| Bank loan from Bank of Beijing | RMB5.1 million (\$0.8 million) | 4.57% | quarterly | August 29, 2018 | operation |
| Bank loan from Bank of Beijing | RMB10.0 million (\$1.5 million) | 5.00% | quarterly | October 13, 2018 | operation |
| Bank loan from Bank of Beijing | RMB4.0 million (\$0.6 million) | 5.00% | quarterly | October 13, 2018 | operation |
| Bank loan from Bank of Beijing | RMB4.9 million (\$0.8 million) | 5.25% | quarterly | May 20, 2020 | construction of the PPV facilities |
| Bank loan from Bank of Beijing | RMB39.7 million (\$6.1 million) | 4.75% | quarterly | May 20, 2020 | construction of the PPV facilities |

On September 18, 2015, Sinovac Beijing entered into a maximum credit facility of RMB50 million (\$7.2 million) with Bank of Beijing to finance its working capital requirements. RMB4.9 million (\$0.8 million) was drawn on August 29, 2017 and will be due on August 29, 2018. RMB5.1 million (\$0.8 million) was drawn on September 6, 2017 and will be due on August 29, 2018. RMB10 million (\$1.5 million) was drawn on October 13, 2017 and will be due on October 13, 2018. RMB4 million (\$0.6 million) was drawn on November 9, 2017 and will be due on October 13, 2018.

On May 20, 2015, Sinovac Beijing entered into a bank loan with Bank of Beijing in the aggregate principal amount of RMB48 million (\$7.4 million) with a term from July 2015 to May 2020 for construction of the PPV facilities. The loan's interest rate is based on the prime rate of a five-year term loan published by the People's Bank of China at the time withdraws are made. Interest is payable quarterly and the loan should be repaid in accordance with a repayment schedule and fully repaid before May 20, 2020. RMB4.9 million (\$0.8 million) was drawn in 2015 with an annual interest rate of 5.25%, and RMB39.7 million (\$6.1 million) was drawn in 2016 with an annual interest rate of 4.75%. Prepaid land lease payments and buildings of Sinovac Beijing with a net book value of RMB15.5 million (\$2.4 million) were pledged as collateral as of December 31, 2017.

| Type | Amount | Annual Interest Rate | Interest Payment | Maturity Date | Purpose |
|--|---------------------------------|----------------------|------------------|-------------------|-------------------------------------|
| Bank loan from China Construction Bank | RMB4.7 million (\$0.7 million) | 4.43% | Monthly | March 26, 2018 | operation |
| Bank loan from China Construction Bank | RMB19.4 million (\$3.0 million) | 4.57% | Monthly | September 4, 2018 | operation |
| Bank loan from China Construction Bank | RMB21.0 million (\$3.2 million) | 4.51% | Quarterly | October 13, 2021 | construction of the sIPV facilities |
| Bank loan from China Construction Bank | RMB29.0 million (\$4.5 million) | 4.51% | Quarterly | October 13, 2021 | construction of the sIPV facilities |
| Bank loan from China Construction Bank | RMB2.0 million (\$0.3 million) | 4.75% | Quarterly | October 13, 2021 | construction of the sIPV facilities |

On March 27, 2017, Sinovac R&D entered into a bank loan with China Construction Bank in the aggregate principal amount of RMB4.7 million (\$0.7 million) to finance its working capital requirements, bearing interest at 5% above the prime rate of a one-year term loan published by the People's Bank of China, at 4.43%. Interest is payable monthly and the loan was repaid on March 26, 2018. Cash collateral of Sinovac R&D with a net book value of RMB5 million (\$0.8 million) was pledged as collateral, which has been released after the loan was fully repaid.

On May 6, 2015, Sinovac Beijing entered into a maximum credit facility of RMB120 million (\$17.2 million) with China Construction Bank to finance its working capital requirements. On May 18, 2017, Sinovac Beijing renewed the credit facility to RMB200 million (\$30.7 million). On September 5, 2017, Sinovac Beijing entered into a bank loan with China Construction Bank in the aggregate principal amount of RMB19.4 million (\$3.0 million) to finance its working capital requirements, bearing interest at 0.27% above the prime rate of a one-year term loan published by the People's Bank of China, at 4.57%. Interest is payable monthly and the loan is payable on September 4, 2018. RMB19.4 million (\$3.0 million) was drawn on September 5, 2017 and will be due on September 4, 2018.

On August 17, 2017, Sinovac Beijing entered into a bank loan with China Construction Bank in the aggregate principal amount of \$3,074 (RMB20 million) with a term from August 2017 to October 2021. The loan bears interest at prime rate of a five-year term loan published by the People's Bank of China, adjusted every 12 months, currently at 4.75%. Interest is payable quarterly and the loan is payable based on the payment schedule and fully repay before October 21, 2021. RMB2.0 million (\$0.3 million) was drawn in 2017. RMB0.8 million (\$0.1 million) and RMB1.2 million (\$0.2 million) are payable on February 25, 2019 and August 25, 2019, respectively.

On May 6, 2015, Sinovac Beijing entered into a maximum credit facility of RMB70 million (\$10.8 million) with China Construction Bank to finance construction of the Sabin inactivated polio vaccine facilities. On October 14, 2016, Sinovac Beijing entered into a bank loan with China Construction Bank in the aggregate principal amount of RMB50 million (\$7.7 million) with a term from October 2016 to October 2021. The loan bears interest at 5% below the prime rate of a five-year term loan published by the People's Bank of China, adjusted every 12 months, currently at 4.51%. Interest is payable quarterly and the loan is payable based on the payment schedule and fully repay before October 13, 2021. RMB21.0 million (\$3.2 million) was drawn in 2016 and RMB29.0 million (\$4.5 million) was drawn in 2017.

Pursuant to the covenants set out in these two bank loan agreements with China Construction Bank, Sinovac Beijing's debt to total assets ratio must not be higher than 80%, current ratio must not be lower than 0.8, contingent liabilities must not be higher than RMB235 million (\$36.1 million) and contingent liabilities as a percentage of total shareholders' equity must not be higher than 50%. We were in compliance with such covenants as of December 31, 2017. Prepaid land lease payment and buildings of the Changping facilities of Sinovac Beijing with a net book value of RMB94.5 million (\$14.5 million) were pledged as collateral against the loan as of December 31, 2017.

| <u>Type</u> | <u>Amount</u> | <u>Annual Interest Rate</u> | <u>Interest Payment</u> | <u>Maturity Date</u> | <u>Purpose</u> |
|-------------------------------------|---------------------------------|-----------------------------|-------------------------|----------------------|----------------|
| Bank loan from China Merchants Bank | RMB20.0 million (\$3.1 million) | 4.57% | Quarterly | February 22, 2018 | Operation |

On February 23, 2017, Sinovac Beijing entered into a one-year term bank loan with China Merchants Bank in the aggregate principal amount of RMB20 million (\$3.1 million) to finance its working capital requirements, bearing interest at 5% above the prime rate of a one-year term loan published by the People's Bank of China, at 4.57% per year. Interest was payable quarterly. The loan was guaranteed by an unrelated third party, with a guarantee fee of RMB0.4 million (\$59,000) over the term of the loan. Trade receivables of Sinovac Beijing with a carrying value of not lower than RMB35 million (\$5.4 million) were pledged as collateral. The loan was repaid on February 22, 2018.

| <u>Type</u> | <u>Amount</u> | <u>Annual Interest Rate</u> | <u>Interest Payment</u> | <u>Maturity Date</u> | <u>Purpose</u> |
|--------------------------|--------------------------------|-----------------------------|-------------------------|----------------------|----------------|
| Bank loan from Citi Bank | RMB4 million (\$0.6 million) | 4.35% | quarterly | January 12, 2018 | operation |
| Bank loan from Citi Bank | RMB4 million (\$0.6 million) | 4.35% | quarterly | January 12, 2018 | operation |
| Bank loan from Citi Bank | RMB2 million (\$0.3 million) | 4.35% | quarterly | January 12, 2018 | operation |
| Bank loan from Citi Bank | RMB8 million (\$1.2 million) | 4.57% | quarterly | January 22, 2018 | operation |
| Bank loan from Citi Bank | RMB4.5 million (\$0.7 million) | 4.60% | quarterly | February 12, 2018 | operation |
| Bank loan from Citi Bank | RMB4.3 million (\$0.7 million) | 4.60% | quarterly | February 13, 2018 | operation |
| Bank loan from Citi Bank | RMB3.1 million (\$0.5 million) | 4.60% | quarterly | February 22, 2018 | operation |

On May 9, 2016, Sinovac Beijing entered into a revolving bank loan with Citi Bank in the aggregate principal limit of RMB30 million (\$4.6 million) to finance its working capital requirements. The revolving loan bears interest at the prime rate of a one-year term loan published by the People's Bank of China, with a weighted average rate at 4.47% and interest is payable quarterly. Each withdraw from the revolving loan has a maximum term of 12 months. RMB4 million (\$0.6 million) was drawn on November 13, 2017 and was repaid on January 12, 2018. RMB4 million (\$0.6 million) was drawn on November 14, 2017 and was repaid on January 12, 2018. RMB2 million (\$0.3 million) was drawn on November 14, 2017 and was repaid on January 12, 2018. RMB8 million (\$1.2 million) was drawn on November 22, 2017 and was repaid on January 22, 2018. RMB4.5 million (\$0.7 million) was drawn on December 13, 2017 and was repaid on February 12, 2018. RMB4.3 million (\$0.7 million) was drawn on December 14, 2017 and was repaid on February 13, 2018. RMB3.1 million (\$0.5 million) was drawn on December 20, 2017 and was repaid on February 22, 2018.

Our weighted average effective interest rate on outstanding borrowings was 4.61%, 4.73% and 4.83% for the years ended December 31, 2017, 2016 and 2015, respectively. We have not historically used, and do not expect to use in the future, any derivative financial instruments to manage our exposure to interest risk.

Restrictions on Cash Dividends

We are a holding company, and we rely in part on dividends paid by our subsidiaries, Sinovac Beijing, Sinovac Dalian, Sinovac R&D and Sinovac Biomed for our cash needs, mainly our operating expenses. The payment of dividends in China is subject to limitations. Regulations in the PRC currently permit payment of dividends only out of accumulated profits as determined in accordance with accounting standards and regulations in China. Our subsidiary is also required to set aside at least a portion of its after-tax profit based on PRC accounting standards each year to fund the statutory surplus reserves.

The reserves can be used to recoup previous years' losses, if any, and, subject to the approval of the relevant PRC government authority, may be converted into share capital in proportion to their existing shareholdings, or by increasing the par value of the shares currently held by them. Such reserves, however, are not distributable as cash dividends. In addition, at discretion of their board of directors, our subsidiaries may allocate a portion of their after-tax profits based on PRC accounting standards to the employee welfare and bonus funds, which shall be utilized for collective staff benefits. In addition, if Sinovac Beijing, Sinovac Dalian, Sinovac R&D or Sinovac Biomed incurs debt on its own behalf in the future, the instruments governing the debt may restrict the ability of one or more of our PRC subsidiaries, as the case may be, to pay dividends or make other distributions to us.

The ability of our subsidiary to convert renminbi into U.S. dollars and make payments to us is subject to PRC foreign exchange regulations. Under these regulations, the renminbi is convertible for current account items, including the distribution of dividends, interest payments, trade and service-related foreign exchange transactions. Conversion of renminbi for capital account items, such as direct investment, loan, security investment and repatriation of investment, however, is still subject to the approval of SAFE. See "Item 10. Additional Information — D. Exchange Controls."

The ability of our subsidiary to distribute dividends requires the financial management team to have operating control of the bank accounts of Sinovac Beijing. While that control exists today, as described above, a representative of Sinobioway Medicine and dozens of unidentified individuals forcibly entered Sinovac Beijing's corporate offices on April 17, 2018 and limited the physical movements of employees in Sinovac Beijing's general manager's office and finance department in an attempt to take control of Sinovac Beijing's official seal, legal documents, accounting seal, financial documents and financial information systems.

Capital Expenditures

We made capital expenditures of \$11.9 million, \$12.7 million and \$5.3 million in 2017, 2016 and 2015, respectively. In 2017, we made \$11.9 million of payments towards property, plant and equipment for construction of PPV, sIPV and varicella production facilities. As of December 31, 2017, our commitments related to capital expenditures of approximately \$0.1 million were primarily for the construction of our sIPV and varicella production facilities. We will finance such commitments through long-term borrowings, proceeds from our public offerings and cash generated from operations.

C. Research and Development, Patents and Licenses, Etc.

See discussions under “Item 5. Operating and Financial Review and Prospects — A. Operating Results — Research and Development Programs.”

D. Trend Information

Other than as disclosed elsewhere in this annual report, we are not aware of any trends, uncertainties, demands, commitments or events for the period from January 1, 2017 to December 31, 2017 that are reasonably likely to have a material adverse effect on our net revenues, income, profitability, liquidity or capital resources, or that caused the disclosed financial information to be not necessarily indicative of future operating results or financial conditions.

E. Off-Balance Sheet Arrangements

We do not, and did not, have any interest in variable interest entities or any other off-balance sheet arrangements that require disclosure.

F. Tabular Disclosure of Contractual Obligations

The following table summarizes our estimated contractual obligations and commitments as of December 31, 2017 for the periods indicated:

| | Payments due by period | | | | More than 5 years |
|---|------------------------|------------------|----------------|--------------|-------------------|
| | Total | Less than 1 year | 1 – 3 years | 4 – 5 years | |
| | | | (in thousands) | | |
| Debt obligations including amount owing to related party (including interest) | 42,967 | 19,584 | 15,101 | 8,282 | - |
| R&D expenses, liabilities and commitment | 2,158 | 2,158 | - | - | - |
| Operating lease obligations | 9,980 | 427 | 1,586 | 1,586 | 6,381 |
| Purchase of facilities commitments | 112 | 112 | - | - | - |
| Accounts payable and accrued liabilities | 59,418 | 59,418 | - | - | - |
| Total | <u>114,635</u> | <u>81,699</u> | <u>16,687</u> | <u>9,868</u> | <u>6,381</u> |

G. Safe Harbor

This annual report on Form 20-F contains forward-looking statements that relate to future events, including our future operating results and conditions, our prospects and our future financial performance and condition, all of which are largely based on our current expectations and projections. The forward-looking statements are contained principally in the sections entitled “Item 3. Key Information — D. Risk Factors,” “Item 4. Information on the Company” and “Item 5. Operating and Financial Review and Prospects.” These statements are made under the “safe harbor” provisions of the U.S. Private Securities Litigation Reform Act of 1995. You can identify these forward-looking statements by terminology such as “may,” “will,” “expect,” “anticipate,” “future,” “intend,” “plan,” “believe,” “estimate,” “is/are likely to” or other and similar expressions. Forward-looking statements involve inherent risks and uncertainties. A number of factors could cause actual results to differ materially from those contained in any forward-looking statement, including but not limited to the following:

- our ability to maximize sales of our existing products within the Chinese market;
- our ability to develop new vaccines;
- our ability to improve our existing vaccines and lower our production costs;
- our ability to expand our manufacturing facilities to meet the needs of the growing Chinese market and other geographic markets;

- our ability to acquire new technologies and products;
- uncertainties in and the timeliness of obtaining necessary governmental approvals and licenses for marketing and sale of our vaccines in certain overseas markets;
- our ability to compete successfully against our competitors;
- risks associated with our corporate structure and the regulatory environment in China;
- litigation between our Company and certain shareholders; and
- other risks outlined in our filings with the Securities and Exchange Commission, or the SEC, including this annual report on Form 20-F.

The forward-looking statements made in this annual report on Form 20-F relate only to events or information as of the date on which the statements are made in this annual report on Form 20-F. Except as required by law, we undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise, after the date on which the statements are made or to reflect the occurrence of unanticipated events. You should read this annual report on Form 20-F completely and with the understanding that our actual future results may be materially different from what we expect.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

A. Directors and Senior Management

The following table sets forth information regarding our directors and executive officers as of the date of this annual report:

| Directors and Executive Officers | Age | Position/Title |
|---|------------|--|
| Weidong Yin | 54 | Chairman, President, Chief Executive Officer |
| Simon Anderson ^{(1) (2) (3)} | 57 | Independent Director |
| Yuk Lam Lo ^{(1) (2) (3)} | 69 | Independent Director |
| Kenneth Lee ^{(2) (3)} | 50 | Independent Director |
| Meng Mei ^{(1) (2) (3)} | 63 | Independent Director |
| Nan Wang | 51 | Chief Financial Officer, Vice President |
| Xiaomei Yin | 53 | Vice President, Sales and Marketing |
| Qiang Gao | 41 | Vice President, Research and Development |
| Jing Li | 43 | Vice President, Quality and Production |

(1) Member of the audit committee.

(2) Member of the corporate governance and nominating committee.

(3) Member of the compensation committee.

Mr. Weidong Yin has served as our chairman, president, chief executive officer and secretary since September 2003. He previously worked as a medical doctor in infectious disease at the China Center for Disease Control and Prevention, Tangshan City, Hebei province. Mr. Yin has been dedicated to hepatitis research for over 20 years and was instrumental in the development of Healive. In addition, Mr. Yin has been appointed as the principal investigator by the Chinese Ministry of Science and Technology for many key governmental R&D programs such as Inactivated Hepatitis A Vaccine R&D, Inactivated SARS Vaccine R&D and New Human Influenza Vaccine (H5N1) R&D. He is also the president of Zhongguancun Listed Companies Association. He obtained his MBA from the National University of Singapore.

Mr. Simon Anderson has served as an independent director of our company since July 2004. He is a member of our audit, compensation, and corporate governance and nominating committees. Mr. Anderson advises companies listed on North American stock exchanges and private businesses in the areas of regulatory compliance, exchange listings and financial operations. He is a member of the Chartered Professional Accountants of British Columbia, having qualified as a Chartered Accountant in 1986. Mr. Anderson serves as a director of IBC Advanced Alloys Corp., which manufactures and processes alloys at its U.S. plants.

Mr. Yuk Lam Lo has served as an independent director of our company since March 2006. Mr. Lo is a member of the audit, compensation and corporate governance and nominating committees. Currently Mr. Lo is serving as the Chairman of the Advisory Council for Food Safety of the Food and Health Bureau HKSAR, an Executive Committee Member of the Chinese Manufacturers' Association of Hong Kong (CMA) and Chairman of the Education Committee of CMA. Mr. Lo is also the Honorary Founding Chairman of Hong Kong Bio-Organization. In the educational area, Mr. Lo has been elected an Honorary Fellow of the Hong Kong University of Science and Technology. He is an Honorary Chairman of Hong Kong Food Safety Association, Adjunct Professor of the Chinese University of Hong Kong and Honorary Professor of several universities in China. Mr. Lo was heavily involved in several committees of the HKSAR Government. He had been appointed as Director of the Hong Kong Applied R&D Fund Co. Ltd., Chairman of the Biotechnology Committee of the Hong Kong Industry & Technology Development Council, and Chairman of Biotechnology Projects Vetting Committee of the Innovation and Technology Fund, HKSAR. In China, Mr. Lo is a Member of Chinese People's Political Consultative Conference in Jilin province, and a Consultant of the Centre for Disease Control and Prevention of China. In the business sector, he is an Independent Director of Luye Pharma Group Limited (2186.HK) and CSPC Pharmaceutical Group Limited (1093.HK).

Mr. Kenneth Lee is an independent director of Sinovac. He has served on our board of directors since May 2011. In July 2012, the board appointed him as a member of the compensation committee and corporate governance and nominating committee. Mr. Lee is a partner at SAIF Partners. SAIF Partners IV L.P. is currently the largest shareholder of Sinovac. Mr. Lee has more than 20 years of experience across private equity investments, corporate finance, and business development in China. He is a non-executive director on the boards of three Chinese portfolio companies publicly listed on the stock exchanges in the United States and Hong Kong and a board director for four other private Chinese companies backed by SAIF Partners. Mr. Lee is a graduate of Amherst College.

Mr. Meng Mei has served as an independent director of our company since March 2012. Mr. Mei is the chairman of compensation committee, and member of the audit and corporate governance and nominating committees. Mr. Mei founded TusPark, a science park established by Tsinghua University in 1994, to incubate high growth companies. He has been the director of TusPark's development center since its inception. Mr. Mei is also the Chairman of TusHoldings Co., Ltd., which is engaged in the development, construction, and management of TusPark and is providing services to enterprises based in TusPark. TusHoldings Co., Ltd. is also involved in venture capital investments in China. Mr. Mei sits on the judging expert panel of China's National Science & Technology Award. He has developed courses on entrepreneurship and new venture formation as a Tsinghua University professor and an entrepreneur. Mr. Mei holds a bachelor's degree in automation from Tsinghua University, PRC.

Ms. Nan Wang has served as our chief financial officer since June 2013. Ms. Wang served as the vice president of Sinovac Beijing from 2001 to 2013 where she oversaw business development, investment and clinical research. From 1988 to 1993, Ms. Wang was a researcher in biology at the Life Science College of Peking University, PRC. From 1993 to 2001, she worked as a manager at SinoBioway. Ms. Wang received her bachelor's degree in biology from Peking University and her master's degree from University of International Business and Economics, PRC. Ms. Wang also received a diploma in financial management from Beijing College for Entrepreneurs, PRC in 2003.

Ms. Xiaomei Yin has served as our vice president since December 29, 2017. She is responsible for our oversee sales and marketing. Ms. Yin joined business development department of Sinovac Beijing in May 2006. She was appointed as director of government relations in February 2010. Before joined us, Ms. Yin worked with Industrial and Commercial Bank of China, one of the major commercial banks in China. She received a bachelor degree in finance from Central University of Finance and Economics, PRC.

Mr. Qiang Gao has served as our vice president since April 2016. Mr. Gao joined Sinovac Beijing in 2002 and has served as quality control manager, quality assurance manager, R&D manager and R&D director at Sinovac Beijing in the past years, and the general manager of Sinovac R&D since 2010. He is responsible for developing our new vaccine products, including EV71 vaccine. Mr. Gao received a master's degree and a bachelor's degree in microbiology from the University of Agriculture, PRC.

Ms. Jing Li has served as our vice president since April 2016. Ms. Li was named as quality person of Sinovac Beijing in March 2015. Since she joined Sinovac Beijing in 2003, she has worked in different roles in production and quality function, including quality assurance vice manager, department manager of hepatitis A vaccine production and director of vaccine production at Sinovac Beijing. Ms. Li is also in charge of the production of our EV71 vaccine. Ms. Li received a master's degree in physiology from the University of Agriculture, PRC.

B. Compensation

In 2017, the aggregate cash compensation paid to our directors and executive officers was approximately \$2.80 million.

Our company may terminate the employment of any director and officers for cause, at any time, without notice or remuneration, for certain acts of such director and officer, such as conviction of or plea of guilty to a felony or to an act of fraud, misappropriation or embezzlement, gross negligence or dishonest acts to our detriment, gross misconduct or a failure to perform agreed duties, death or disability (physical or mental impairment). Our company may also terminate his or her employment without cause, at any time, upon a one month's written notice. Our directors and officers may terminate their employment, at any time, with a one-month prior written notice to our company for good reason, including material diminution in their authority, duties, responsibilities or cash compensation as detailed in their employment agreements, or in event of any action or inaction that constitutes a material breach by our company under the employment agreement, in the manner set forth in their employment agreements. Upon termination of his or her employment with our company by our company without cause or by him or her for good reason, such director and executive officer is entitled to receive severance benefits including cash payment equal to the amount set forth in his or her employment agreement. In addition, all the share options and restricted share award granted to him or her under our stock/share incentive plans will become fully vested on the employment termination date and such share options will remain exercisable for eighteen months following the employment termination date.

The bonus plan of the executive officers is made based on our annual performance in different functions and the respective key result areas of these functional teams. Each vice president's bonus is determined based on the key corporate development objectives and key performance index set by the compensation committee and approved by the board at the beginning of the year. The bonus payoff plan is approved by the board.

Our shareholders have authorized the board of directors to administer two share incentive plans which in aggregate provide for the issuance of up to 9,000,000 shares of common stock, including 5,000,000 shares reserved under the 2003 Stock Option Plan and 4,000,000 shares reserved under 2012 Share Incentive Plan. The following tables summarize, as of December 31, 2017, the outstanding options and regular shares that we granted to several of our directors, executive officers, principal shareholders and to other individuals as a group, all of which were made under our 2012 Share Incentive Plan.

| Name | 2012 Share Incentive Plan | | | Grant Date | Expiration Date | Total |
|-------------------|---------------------------|-------------------|--------------------------|-------------|-----------------|-----------|
| | Restricted Shares | Number of Options | Exercise Price(\$/Share) | | | |
| Weidong Yin | - | 150,000 | 4.98 | May 1, 2015 | April 30, 2023 | 150,000 |
| Simon Anderson | - | 40,000 | 4.98 | May 1, 2015 | April 30, 2023 | 40,000 |
| Yuk Lam Lo | - | 40,000 | 4.98 | May 1, 2015 | April 30, 2023 | 40,000 |
| Meng Mei | - | 40,000 | 4.98 | May 1, 2015 | April 30, 2023 | 40,000 |
| Kenneth Lee | - | 40,000 | 4.98 | May 1, 2015 | April 30, 2023 | 40,000 |
| Nan Wang | 22,500 | 90,000 | 4.98 | May 1, 2015 | April 30, 2023 | 112,500 |
| Ming Xia | 22,500 | 45,000 | 4.98 | May 1, 2015 | April 30, 2023 | 67,500 |
| Xiaomei Yin | 7,500 | 20,000 | 4.98 | May 1, 2015 | April 30, 2023 | 27,500 |
| Qiang Gao | 18,750 | 40,000 | 4.98 | May 1, 2015 | April 30, 2023 | 58,750 |
| Jing Li | 18,750 | 80,000 | 4.98 | May 1, 2015 | April 30, 2023 | 98,750 |
| Others as a group | 182,000 | 443,500 | 4.98 | May 1, 2015 | April 30, 2023 | 625,500 |
| Subtotal | 272,000 | 1,028,500 | 4.98 | May 1, 2015 | April 30, 2023 | 1,300,500 |

| Name | Restricted Shares | Grant Date |
|-------------------|-------------------|---------------|
| Weidong Yin | 160,000 | March 7, 2018 |
| Nan Wang | 160,000 | March 7, 2018 |
| Xiaomei Yin | 120,000 | March 7, 2018 |
| Qiang Gao | 120,000 | March 7, 2018 |
| Jing Li | 120,000 | March 7, 2018 |
| Others as a group | 1,320,000 | March 7, 2018 |
| Subtotal | 2,000,000 | March 7, 2018 |

We have not set aside or accrued any amount of cash to provide pension, retirement or other similar benefits to our officers and directors. Our PRC subsidiaries and consolidated affiliated entities as well as their subsidiaries are required by law to make contributions equal to certain percentages of each employee's salary for his or her retirement benefits, medical insurance benefits, housing funds, unemployment and other statutory benefits.

2003 STOCK OPTION PLAN

Our board of directors adopted the 2003 Stock Option Plan, or the 2003 Plan, on November 1, 2003. The purpose of the plan is to attract and retain the best available personnel for positions of substantial responsibility, provide additional incentive to employees, directors and consultants and promote the success of our business. Our board of directors believes that our company's long-term success depends on our ability to attract and retain superior individuals who, by virtue of their ability, experience and qualifications, make important contributions to our business.

Set forth below is a summary of the principal terms of the 2003 Plan.

- **Size of plan.** We have reserved an aggregate of 5,000,000 of our common shares for issuance under the 2003 Plan. As of December 31, 2017, the 2003 Plan has been expired and an aggregate of 4,696,900 common shares have been issued pursuant to options issued under the 2003 Plan.
- **Administration.** The 2003 Plan is administered by our board of directors. The board will determine the provisions, terms and conditions of each option grant, including without limitation the option vesting schedule or exercise installment, the option exercise price, payment contingencies and satisfaction of any performance criteria.

- **Vesting schedule.** The vesting schedules of options granted will be specified in the applicable option agreements.
- **Option agreement.** Options granted under the 2003 Plan are evidenced by option agreements that contain, among other things, provisions concerning exercisability and forfeiture upon termination of employment or consulting arrangements by reason of death or otherwise, as determined by our board. In addition, the option agreement also provides no option shares will be issued under the plan unless the Securities Act has been fully complied with.
- **Option term.** The term of options granted under the 2003 Plan may not exceed ten years from the date of grant.
- **Termination of options.** Where the option agreement permits the exercise of the options granted for a certain period of time following the recipient's termination of services with us, the options will terminate to the extent any options are not exercised or purchased on the last day of the specified period or the last day of the original term of the options, whichever occurs first.
- **Change of control.** If a third-party acquires us through the purchase of all or substantially all of our assets, a merger or other business combination, all outstanding stock options will become fully vested and exercisable immediately prior to such transaction.
- **Termination of plans.** Unless terminated earlier, the Plan will expire in 2023. Our board of directors has the authority to terminate the 2003 Plan prior to the expiry of the plan provided that such early termination shall not affect the options then outstanding under the plan.

2012 SHARE INCENTIVE PLAN

In August 2012, our shareholders adopted a 2012 Share Incentive Plan, or the 2012 Plan. The maximum aggregate number of common shares which may be issued pursuant to all awards under the 2012 Plan is 4,000,000 shares. The following paragraphs describe the principal terms of the 2012 Plan.

Types of Awards

The types of awards we may grant under the plan include the options to purchase our common shares at a specified price and in a specified period determined by our board. Under the 2012 Plan, we may also grant awards of our (1) restricted shares, (2) restricted share units, (3) dividend equivalents, (4) deferred shares, (5) share payments and (6) share appreciation rights under the terms and conditions determined by our board of directors.

Eligibility

We may grant awards to the directors, officers, advisors and employees of us and our wholly owned subsidiaries and any entity which may thereafter be established.

Plan Administration

Our board of directors will administer the 2012 Plan. The board will determine the terms and conditions of each grant, including but not limited to, the exercise, grant or purchase prices, any reload provision, any restrictions or limitations on the awards, vesting schedules, restrictions on the exercisability of the awards, any accelerations or waivers, and any provision related to non-competition and recapture of gain on the awards.

Award Agreement

Awards granted under the plan will be evidenced by an award agreement that will set forth the terms, conditions and limitations for each award. The award agreement should be signed by the employee and a director or an officer of us. Share awards may be evidenced by way of an issuance of certificates or book entries with appropriate legends. The certificates and book entry procedures may be subject to counsels' advice, stop-transfer orders or other conditions or restrictions where the plan administrator deems necessary to comply with the required laws and regulations.

Vesting

The 2012 Plan provides that the administrator may set the period during which an option or a share appreciation right can be exercised and may determine that an option or a share appreciation right may not be exercised for a specified period after it is granted. Such vesting can be based on criteria selected by the administrator. At any time after the grant of an option or a share appreciation right, the administrator may, in its sole discretion and subject to the terms and conditions it determines, accelerate the period during which an option or a share appreciation right vests. No portion of an option or a share appreciation right exercisable at the termination of service of an option or a share appreciation right holder with our company or subsidiaries can become exercisable afterwards, unless otherwise provided by the administrator.

Exercise Price and Term of Awards

The exercise price per share of options granted under the 2012 Plan is determined by the plan administrator in the award agreement. The price may be fixed or variable related to the fair market value of our ordinary shares. The term of any option granted should not exceed ten years. However, in the case where our incentive option is granted to an individual who, at the date of grant, owns more than ten percent of the total voting power of all classes of our shares, the price granted shall not be less than 110% of the fair market value on the date of grant and the option is exercisable for no more than five years from the date of grant.

For common share awards granted under the 2012 Plan, namely (1) restricted shares, (2) restricted share units, (3) dividend equivalents, (4) deferred shares, and (5) share payments, the consideration shall not be less than the par value of the shares purchased. The terms of the share awards are set by the plan administrator in its sole discretion.

The exercise price of share appreciation right under the 2012 Plan is determined by the plan administrator and set forth in the award agreement which may be a fixed or variable price related to the fair market value of the shares. The term of the share appreciation right will not exceed ten years.

The approval of shareholders is required for downward adjustment of the exercise prices of options or share appreciation rights. A downward adjustment of the exercise prices of options or share appreciation rights means (i) lowering the exercise price of outstanding options or share appreciation rights, or (ii) cancelling outstanding options or share appreciation rights in exchange for cash, other awards, or options or share appreciation rights with an exercise price that is less than the exercise price of the original options or share appreciation rights.

Transfer Restrictions

The awards granted under the 2012 Plan may not be sold, pledged, assigned or transferred other than by will or the laws of descent and distribution or, subject to the consent of the plan administrator, as required under the applicable laws.

Amendments or Termination

The 2012 Plan provides that in the event of any changes affecting our common shares or our share price, the plan administrator can make proportional and equitable adjustments to reflect such changes. Upon or in anticipation of a corporate transaction, including acquisition, disposal of substantially all or all assets, reverse takeover, dissolution, the plan administrator should in its discretion provide for replacement or assumption of such award. In the event of other changes, the board of directors should in its discretion make adjustments in the number and class of shares subject to awards outstanding on the date of such change to prevent dilution or enlargement of rights. The 2012 Plan will expire and no further awards may be granted after the tenth anniversary of the date the plan was adopted.

C. Board Practices

Board of Directors

Our Articles of Incorporation prescribe that we should have a minimum of one and a maximum of 15 directors. Currently, our board of directors comprises five board members, four of whom are independent. A director is not required to hold any shares in the company by way of qualification. A director may vote with respect to any contract, proposed contract or arrangement in which he is materially interested provided that such director must disclose his interest in the contract or arrangement. There is no age limit requirement for directors. Under Antigua law, our directors have a duty of loyalty to act honestly, in good faith and with a view to our best interests. Our directors also have a duty to exercise the skill they actually possess and such care and diligence that a reasonably prudent person would exercise in comparable circumstances. In fulfilling their duty of care to us, our directors must ensure compliance with our Articles of Incorporation and By-laws, as amended and re-stated from time to time. A shareholder has the right to seek damages if a duty owed by our directors is breached.

The functions and powers of our board of directors include, among others:

- convening shareholders' annual general meetings and reporting its work to shareholders at such meetings;
- declaring dividends and distributions;
- appointing officers and determining the term of office of officers;
- exercising the borrowing powers of our company and mortgaging the property of our company; and
- approving the transfer of shares of our company, including the registering of such shares in our share register.

As described above, on March 5, 2018, we announced the re-election of the members of our board of directors—Mr. Weidong Yin, Mr. Yuk Lam Lo, Mr. Simon Anderson, Mr. Kenneth Lee, and Mr. Meng Mei—at our 2017 AGM held on February 6, 2018. We also announced that we had determined, after consultation with our Antigua legal counsel, that an alternative, pre-printed ballot not made available to all our shareholders and purportedly submitted at our 2017 AGM by the Shareholder Group was invalid. On March 13, 2018, 1Globe filed a complaint against our company in the Eastern Caribbean Supreme Court in the High Court of Justice, Antigua and Barbuda, to dispute the results of the election.

Terms of Directors and Executive Officers

Our officers are elected by and serve at the discretion of the board of directors. Our directors are not subject to a term of office and hold office until a successor is elected at the next annual shareholders' meeting. A director will be removed from office automatically if, among other things, the director (i) becomes bankrupt or makes any arrangement or composition with his creditors or (ii) dies or is found by our company to be or becomes of unsound mind. None of our directors has a service contract with us or any of our subsidiaries providing for benefits upon termination of employment.

Committees of the Board of Directors

Our board of directors has established an audit committee, a compensation committee and a corporate governance and nominating committee.

Audit Committee

Our audit committee consists of Messrs. Simon Anderson, Yuk Lam Lo and Meng Mei, and is chaired by Simon Anderson, all of whom satisfy the "independence" requirements of Rule 5605 of the NASDAQ Listing Rules and Rule 10A-3 under the Securities Exchange Act of 1934. The audit committee oversees our accounting and financial reporting processes and the audits of the financial statements of our company. The audit committee is responsible for, among other things:

- selecting our independent auditors and pre-approving all auditing and non-auditing services permitted to be performed by our independent auditors;
- reviewing with our independent auditors any audit problems or difficulties and management's response;
- reviewing and approving all proposed related party transactions, as defined in Item 404 of Regulation S-K under the Securities Act;
- discussing the annual audited financial statements with management and our independent auditors;

- reviewing major issues as to the adequacy of our internal controls and any special audit steps adopted in light of material control deficiencies;
- annually reviewing and reassessing the adequacy of our audit committee charter;
- such other matters that are specifically delegated to our audit committee by our board of directors from time to time;
- meeting separately and periodically with management and our internal and independent auditors; and
- reporting regularly to the full board of directors.

In 2017 our audit committee held meetings or passed resolutions by unanimous written consent eight times.

Compensation Committee

Our compensation committee consists of Messrs. Meng Mei, Simon Anderson, Yuk Lam Lo, and Kenneth Lee, and is chaired by Mr. Meng Mei, all of whom satisfy the “independence” requirements of Rule 5605 of the NASDAQ Listing Rules and Rule 10C-1 under the Securities Exchange Act of 1934. Our compensation committee assists the board in reviewing and approving the compensation structure of our directors and executive officers, including all forms of compensation to be provided to our directors and executive officers. Members of the compensation committee are not prohibited from direct involvement in determining their own compensation. Our chief executive officer may not be present at any committee meeting during which his compensation is deliberated. The compensation committee is responsible for, among other things:

- approving and overseeing the compensation package for our executive officers;
- reviewing and making recommendations to the board with respect to the compensation of our directors;
- reviewing and approving corporate goals and objectives relevant to the compensation of our chief executive officer, evaluating the performance of our chief executive officer in light of those goals and objectives, and setting the compensation level of our chief executive officer based on this evaluation; and
- reviewing periodically and making recommendations to the board regarding any long-term incentive compensation or equity plans, programs or similar arrangements, annual bonuses, employee pension and welfare benefit plans.

In 2017, our compensation committee held meetings or passed resolutions by unanimous written consent twice.

Corporate Governance and Nominating Committee

Our corporate governance and nominating committee consists of Messrs. Yuk Lam Lo, Simon Anderson, Kenneth Lee and Meng Mei, and is chaired by Mr. Yuk Lam Lo, all of whom satisfy the “independence” requirements of Rule 5605 of the NASDAQ Listing Rules. The corporate governance and nominating committee assists the board of directors in identifying individuals qualified to become our directors and in determining the composition of the board and its committees. The corporate governance and nominating committee is responsible for, among other things:

- identifying and recommending to the board nominees for election or re-election to the board, or for appointment to fill any vacancy;
- reviewing annually with the board the current composition of the board in light of the characteristics of independence, age, skills, experience and availability of service to us;
- identifying and recommending to the board the directors to serve as members of the board’s committees;
- advising the board periodically with respect to significant developments in the law and practice of corporate governance as well as our compliance with applicable laws and regulations and making recommendations to the board on all matters of corporate governance and on any corrective action to be taken; and

- monitoring compliance with our code of business conduct and ethics, including reviewing the adequacy and effectiveness of our procedures to ensure proper compliance.

In 2017, our corporate governance and nominating committee did not hold meetings or passed resolutions, instead, the matters for discussion were combined to the meetings or resolutions by the board of directors.

Interested Transactions

A director may vote in respect of any contract or transaction in which he or she is interested, provided that the nature of the interest of any directors in such contract or transaction is disclosed by him or her at or prior to its consideration and any vote in that matter.

Remuneration and Borrowing

The directors may determine remuneration to be paid to the directors. The compensation committee assists the directors in reviewing and approving the compensation structure for the directors. The directors may exercise all our powers to borrow money and to mortgage or charge its undertaking, property and uncalled capital, and to issue debentures or other securities whether outright or as security for any debt obligations of our company or of any third party.

D. Employees

As of December 31, 2017, 2016 and 2015, we had 644, 724 and 646 full-time employees, respectively. Of our workforce as of December 31, 2017, about 98 employees are primarily engaged in research and development, 66 employees are engaged in sales and marketing, 415 employees in production related, and 65 employees in administration. As of December 31, 2017, we have a total of 156 temporary employees. We consider our relationship with our employees to be good.

E. Share Ownership

The following table sets forth information with respect to the beneficial ownership of our common shares, as of December 31, 2017, by:

- each of our directors and executive officers; and
- each person/organization known to us to own beneficially more than 5% of our common shares.

The calculations in the table below are based on 57,281,861 common shares outstanding as of December 31, 2017. Beneficial ownership is determined in accordance with the rules and regulations of the SEC. In computing the number of shares beneficially owned by a person and the percentage ownership of that person, we have included shares that the person has the right to acquire within 60 days, including through the exercise of any option, warrant or other right or the conversion of any other security. These shares, however, are not included in the computation of the percentage ownership of any other person.

| | Shares Beneficially Owned | |
|---|---------------------------|--------|
| | Number | % |
| Directors and Executive Officers: | | |
| Weidong Yin | 6,124,500 | 10.56% |
| Simon Anderson | * | * |
| Yuk Lam Lo | * | * |
| Meng Mei | * | * |
| Kenneth Lee | * | * |
| Nan Wang | * | * |
| Ming Xia | * | * |
| Xiaomei Yin | * | * |
| Qiang Gao | * | * |
| Jing Li | * | * |
| All directors and executive officers as a group | 6,824,847 | 11.54% |
| Principal Shareholders | | |
| SAIF Partners IV ⁽¹⁾ | 10,780,820 | 18.82% |
| 1Globe Capital LLC ⁽²⁾ | 9,353,092 | 16.33% |
| Chiang Li Family ⁽³⁾ | 3,459,763 | 6.04% |
| Samuel D. Isaly ⁽⁴⁾ | 2,667,500 | 4.66% |

* Less than 1% of our common shares.

- (1) According to the Amendment No. 6 to Schedule 13D filed with the SEC on June 27, 2017 by SAIF Partners IV L.P., SAIF IV GP, L.P. and SAIF IV GP Capital Ltd.
- (2) According to the Schedule 13D filed with the SEC on July 7, 2017 and the Amendment No. 1 to the Schedule 13D filed with the SEC on March 23, 2018.
- (3) According to the Schedule 13G filed with the SEC on April 11, 2016.
- (4) According to the Amendment No. 1 to 13G filed with the SEC on February 11, 2016, consists of (i) 1,219,500 common shares beneficially owned by OrbiMed Advisors LLC and (ii) 1,448,000 common shares beneficially owned by OrbiMed Capital LLC. OrbiMed Advisors LLC and OrbiMed Capital LLC are investment advisors, and Samuel D. Isaly is the control person of OrbiMed Advisors LLC and OrbiMed Capital LLC.

None of our existing shareholders has different voting rights from other shareholders. Except for the proposed going private transaction as disclosed in “Item 4. Information on the Company — History and Development of the Company” or elsewhere in this annual report and the complaint against filed by 1Globe against the Company in the Eastern Caribbean Supreme Court in the High Court of Justice, Antigua and Barbuda, or the Antigua Court, as disclosed in “Item 8. Financial Information — A. Consolidated Statements and Other Financial Information — Legal and Administrative Proceedings” or elsewhere in this annual report, we are not aware of any arrangement that may, at a subsequent date, result in a change of control of our company.

As of December 31, 2017, 57,281,861 of our common shares were issued and outstanding. Approximately 88% of the issued and outstanding shares were held by the record shareholders in the United States.

For the options granted to our directors, officers and employees, please refer to “— B. Compensation.”

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. Major Shareholders

Please refer to “Item 6. Directors, Senior Management and Employees — E. Share Ownership.”

B. Related Party Transactions

Privatization

On June 26, 2017, we entered into the Amalgamation Agreement with Sinovac (Cayman) Limited, or Parent, and Sinovac Amalgamation Sub Limited, or Amalgamation Sub, a wholly owned subsidiary of Parent. Pursuant to the Amalgamation Agreement, Parent will acquire Sinovac Biotech Ltd. for cash consideration equal to \$7.00 per common share. Immediately following the consummation of the transactions contemplated by the Amalgamation Agreement, Parent will be beneficially owned by a consortium, or the Buyer Consortium, comprising Mr. Weidong Yin, the chairman, president and chief executive officer of Sinovac Biotech Ltd., SAIF, C-Bridge Healthcare Fund II, L.P., Advantech Capital L.P., Vivo Capital Fund VIII, L.P. and Vivo Capital Surplus Fund VIII, L.P. Subject to the terms and conditions of the Amalgamation Agreement, at the effective time of the amalgamation, Amalgamation Sub will be amalgamated with and into Sinovac Biotech Ltd., with Sinovac Biotech Ltd. continuing as the surviving corporation and a wholly owned subsidiary of Parent, or the Amalgamation.

Our board of directors, acting upon the unanimous recommendation of the Special Committee, unanimously approved the Amalgamation Agreement and the transactions contemplated by the Amalgamation Agreement, including the Amalgamation, and resolved to recommend that our shareholders authorize and approve the Amalgamation Agreement and the transactions contemplated by the Amalgamation Agreement, including the Amalgamation.

The Amalgamation is subject to customary closing conditions, including approval by an affirmative vote of holders of Shares representing at least two-thirds of our common shares present and voting in person or by proxy as a single class at a meeting of our shareholders, which will be convened to consider the authorization and approval of the Amalgamation Agreement and the transactions contemplated by the Amalgamation Agreement, including the Amalgamation, and the other closing conditions specified in the Amalgamation Agreement. If completed, the Amalgamation will result in Sinovac Biotech Ltd. becoming a privately-held company and our common shares will no longer be listed on NASDAQ.

On March 26, 2018, we amended the Amalgamation Agreement to extend its termination date to April 26, 2018. On April 26, 2018, we further amended the Amalgamation Agreement to extend its termination date to May 26, 2018.

Transaction with Yuk Lam Lo

Sinovac Hong Kong is using part of the office of Mr. Yuk Lam Lo, one of our independent directors, as its office. We do not pay any rent to Mr. Yuk and only pay our share of the utilities and property management fees, which totaled \$4,000, \$7,000 and nil in 2015, 2016 and 2017, respectively.

Transactions with Certain Directors and Affiliates

We entered into two operating lease agreements with SinoBioway, the parent company of Sinobioway Medicine which is the non-controlling shareholder of Sinovac Beijing, in 2004, to lease Sinovac Beijing's production plant and laboratory in Beijing with annual lease payments totaling RMB2.3 million (\$0.4 million). The leases commenced on August 12, 2004 and have a term of 20 years. One of the lease agreements was amended on August 12, 2010 to increase the rent from RMB0.5 million (\$75,000) to RMB1.4 million (\$0.2 million) per year.

In June 2007, we entered into another operating lease agreement with SinoBioway for an annual lease payment of RMB2.0 million (\$0.3 million) to expand Sinovac Beijing's production plant in Beijing. The lease commenced in June 2007 and has a term of 20 years.

In September 2010, we entered into another operating lease agreement with SinoBioway for an annual lease payment of RMB1.0 million (\$0.2 million) to expand Sinovac R&D's business. The lease commenced on September 30, 2010 and has a term of five years.

On April 8, 2013, we entered into three supplemental agreements with SinoBioway, under which the expiration date of three of the operating lease agreements was extended to April 7, 2033.

Loan from a non-controlling shareholder

In 2011, Sinovac Dalian entered into an agreement to borrow RMB20.0 million (\$3.1 million) loan from its non-controlling shareholder, Dalian Jin Gang Group. The loan was unsecured, bearing interest at 7.2% per year. RMB4.0 million (\$0.6 million) was repaid on September 25, 2014. No repayments were made in 2017 and 2016, respectively. In 2017, Sinovac Dalian entered into an agreement to borrow RMB30.0 million (\$4.6 million) loan from its non-controlling shareholder, Dalian Jin Gang Group. The loan was unsecured, bearing interest at 6.0% per year. No repayments were made in 2017.

Share Options

See "Item 6. Directors, Senior Management and Employees — B. Compensation — 2003 Stock Option Plan" and "Item 6. Directors, Senior Management and Employees — B. Compensation — 2012 Share Incentive Plan."

C. Interests of Experts and Counsel

Not applicable.

ITEM 8. FINANCIAL INFORMATION

A. Consolidated Statements and Other Financial Information

We have appended consolidated financial statements filed as part of this annual report.

Legal and Administrative Proceedings

We may be subject to legal proceedings, investigations and claims relating to the conduct of our business from time to time.

The Beijing People's Court issued five judgements in 2016 and 2017. These judgments were related to corrupt conduct allegedly engaged in by a former official of the Center for Drug Evaluation in CFDA, his wife and his son. These judgments found that the official and his wife had engaged in a practice of improperly soliciting and accepting payments from various individuals involved in the vaccine products industry. According to the judgments, one of the individuals solicited by the official was Mr. Weidong Yin, our chairman, president and chief executive officer. It was asserted in the judgments that Mr. Weidong Yin made three payments, and arranged for a loan, to the official and his wife, in the total amount of RMB550,000 (\$77,000) between 2002 and 2011. Mr. Weidong Yin was not charged with any offense or improper conduct and he cooperated as a witness with the procuratorate. To our knowledge, the Chinese authorities have not commenced any legal proceedings or government inquiries against Mr. Yin. In December 2016, our audit committee authorized the commencement of an internal investigation into the allegations made in the judgements. The audit committee engaged Latham & Watkins as independent counsel to assist with the investigation.

In 2017 and 2018, we became aware of certain judgments based on bribery charges issued by Chinese courts in four provinces against various officials of the Chinese Center for Disease Control (the "CDC"). While these judgments appear to reflect an industry-wide investigation focused on CDC officials, they also referenced nine of the Company's former salespersons, together with sales personnel from several other Chinese vaccine companies and distributors. These judgments did not name, and no charges were brought against, the Company or any of its directors or officers as defendants. To the best of our knowledge, the nine referenced employees cooperated with the procuratorate. The procuratorate did not contact the Company for cooperation. Upon becoming aware of these judgments, our Audit Committee expanded its internal investigation to review matters related to these judgments and the Company's sales practices and policies, and further engaged Latham & Watkins to continue the independent investigation with the expanded scope. Recently, the Company became aware that one of the nine former sales employees has been convicted for giving bribes. The judgment states that this former sales employee took these actions without knowledge of the Company. His criminal penalty was waived by the court. The Company has become aware that another one of the nine former sales employees might also be investigated by the procuratorate.

After we publicly announced the internal investigation arising from the allegations in a research report in December 2016, we were notified by the SEC in February 2017 of an enforcement inquiry related to the matters discussed in the report, and in April 2017 we received a subpoena from the SEC requesting documents. In September 2017, we received an inquiry from the Department of Justice (the "DOJ") and we have been cooperating with the DOJ. The SEC and DOJ have requested information regarding the judgments discussed above, and we are cooperating with these requests.

Also in February 2017, we received an inquiry from NASDAQ related to the same matter. Further, in May 2018, we received an inquiry from NASDAQ requesting information related to the actions by Sinobioway and their impact on our operations and financial reporting. We have cooperated with both of these NASDAQ inquiries.

We take these matters very seriously and are committed to conducting business in compliance with all applicable laws. However, at this time, we are unable to predict, what, if any, action may be taken by NASDAQ, the SEC and the DOJ or any penalties or remedial measures these agencies may seek, but intend to continue to cooperate with these agencies. Any determination that our operations or activities are not in compliance with existing laws or regulations could result in the imposition of fines, civil and criminal penalties, and equitable remedies, including disgorgement or injunctive relief. We cannot determine as to whether an ultimate unfavorable outcome is either probably or remote, nor reasonably estimate the amount or range of the potential liability, if any, related to these matters resulting from any proceedings that may be commenced by the SEC or any other governmental authorities.

On July 3, 2017, a securities class action complaint was filed in the U.S. District Court for the District of New Jersey against the Company and three of its current and former officers: Mr. Weidong Yin, the Company's current chief executive officer, Ms. Nan Wang, the Company's current chief financial officer, and Mr. Danny Chung, the Company's former chief financial officer. The complaint asserts that statements in the Company's annual filings for fiscal years 2012 through 2015 were false and misleading because they failed to disclose matters relating to the alleged bribery incidents, among other allegations. On September 6, 2017, the plaintiff has filed the notice of voluntary dismissal. The Court granted the dismissal without prejudice.

On July 12, 2017, an alleged shareholder of the Company filed a putative class action complaint in the Supreme Court of the State of New York against the Company, its directors, and certain entities related to the Amalgamation. The complaint alleges that the Company's directors breached their fiduciary duties by, among other things, entering into a self-dealing transaction at a price below fair value and failing to take steps to maximize the value of the Company. The complaint also alleges that the Company aided and abetted those alleged breaches of fiduciary duty. The complaint seeks, among other things, an injunction preventing completion of the Amalgamation, rescission of the Amalgamation to the extent it is implemented, damages, and attorneys' fees. The Company is vigorously defending this lawsuit; however, the Company cannot determine as to whether an ultimate unfavorable outcome is either probably or remote, nor reasonably estimate the amount or range of the potential liability for this case at this stage.

On March 5, 2018, the Company filed a lawsuit in the Court of Chancery of the State of Delaware seeking a determination whether IGlobe, The Chiang Li Family, OrbiMed and other shareholders of the Company had triggered our Rights Plan by forming a group holding approximately 45% of the Company's outstanding shares, in excess of the plan's threshold of 15%, and acting in concert prior to the 2017 AGM. Our Rights Plan is intended to promote the fair and equal treatment of all Sinovac shareholders and ensure that no person or group can gain control of Sinovac through undisclosed voting arrangements, open market accumulation or other tactics potentially disadvantaging the interest of all shareholders.

On April 12, 2018, IGlobe filed an amended answer to the Company's complaint, counterclaims, and a third-party complaint against Mr. Weidong Yin alleging, among other allegations, that our Rights Plan is not valid, that Mr. Weidong Yin and the Buyer Consortium had previously triggered our Rights Plan, and that IGlobe did not trigger our Rights Plan. The Company and its board of directors believes that the actions taken by the board of directors were appropriate under the circumstances and that the allegations of the counterclaim and third-party complaint are without merit. IGlobe asks for various measures of equitable relief and also includes a claim for its costs, including attorneys' fees. This litigation is currently in the pre-trial phase with a decision expected before the end of 2018, subject to appeal. The Company cannot predict whether an ultimate outcome will be favorable or unfavorable, nor estimate the amount or range of potential loss (if any) at this time.

On March 5, 2018, the Company also filed a lawsuit in the United States District Court for Massachusetts alleging violations of Section 13(d) of the Securities Exchange Act of 1934 by IGlobe and The Chiang Li Family. The lawsuit alleges, among other things, that the defendant shareholders failed to make required disclosures on Schedule 13D regarding their intentions to attempt to replace the Company's board of directors. The Company is vigorously pursuing this lawsuit; however, the Company cannot predict whether an ultimate outcome will be favorable or unfavorable, nor estimate the amount or range of potential loss (if any) at this time.

On April 9, 2018, the Company received a document request from SEC requesting all of the Company's documents concerning IGlobe, the Chiang Li Family, OrbiMed, certain other shareholders, and their affiliates. We have been cooperating with the SEC. We understand the SEC is investigating whether IGlobe, and possibly other shareholders, violated the U.S. securities laws. We do not have any information to suggest the SEC is investigating the actions of the Company or its officers and directors.

On March 13, 2018, IGlobe filed a complaint against the Company in the Eastern Caribbean Supreme Court in the High Court of Justice, Antigua and Barbuda, or the Antigua Court. The complaint seeks a declaration that the five persons purportedly proposed on the Non-Public Submission at the 2017 AGM were elected as directors of the Company at that meeting, an order of the Antigua Court that those directors be installed as the Company's board of directors, and a declaration that any actions taken on behalf of the Company at the direction of the board of directors since the 2017 AGM are null and void. On April 10, 2018, IGlobe filed a notice of application in the Antigua Court seeking an order declaring the result of the disputed election, an urgent order restraining the Company's board of directors from acting, pending determination of the dispute, including acting to initiate or continue litigation against the Shareholder Group, and other related relief. The Company attended the first hearing on May 9, 2018 and there will be further hearings at which the Company will continue to vigorously defend the litigation; however, the Company cannot predict or estimate an outcome or economic burden for this case at this time.

On April 4, 2018, Sinovac Hong Kong filed a complaint against Sinovac Beijing in the Haidian District Court of Beijing. The complaint seeks a declaration that the board resolutions dated February 6, 2018 purporting to appoint Mr. Aihua Pan as the general manager of Sinovac Beijing are invalid. On May 9, 2018, Sinobioway Medicine filed a complaint against Sinovac Beijing in the Haidian District Court of Beijing. The complaint seeks a declaration that the board resolutions passed on February 28, 2018 to appoint Mr. Weidong Yin and other senior management members are invalid. As of the date of this annual report, both lawsuits are pending and no hearing has been held. The Company cannot predict whether an ultimate outcome will be favorable or unfavorable, nor estimate the amount or range of potential loss (if any) at this time.

Dividend Policy

We have never declared or paid any dividends, nor do we have any present plan to pay any cash dividends on our common shares in the foreseeable future. We currently intend to retain most, if not all, of our available funds and any future earnings to operate and expand our business.

Our board of directors has complete discretion on whether to pay dividends. Even if our board of directors decides to pay dividends, the form, frequency and amount will depend upon our future operations and earnings, capital requirements and surplus, general financial condition, contractual restrictions and other factors that the board of directors may deem relevant. Cash dividends on our common shares, if any, will be paid in U.S. dollars.

We are a holding company, and we rely on the dividends paid by our majority-owned subsidiaries, Sinovac Beijing and Sinovac Dalian, wholly owned subsidiaries Sinovac R&D and Sinovac Biomed through Sinovac Hong Kong, for our cash needs, including the funds necessary to pay any dividends and other cash distributions to our shareholders, service any debt we may incur and pay our operating expenses. The payment of dividends in China is subject to limitations. Regulations in the PRC currently permit payment of dividends by our PRC subsidiaries only out of accumulated profits as determined in accordance with accounting standards and regulations in China. In accordance with the regulations in China, Sinovac Beijing, Sinovac Dalian, Sinovac R&D and Sinovac Biomed are required to set aside at least 10% of its after-tax profits each year to contribute to its reserve fund until the accumulated balance of such reserve fund reaches 50% of the registered capital of each company. Sinovac Beijing, Sinovac Dalian, Sinovac R&D and Sinovac Biomed are required to set aside, at the discretion of their respective board of directors, a portion of its after-tax profits to their employee welfare and bonus funds.

Furthermore, pursuant to the double tax arrangement between Hong Kong and PRC, dividends paid by a foreign-invested enterprise in China to its direct holding company in Hong Kong will be subject to withholding tax at a rate of no more than 5% (if the foreign investor owns directly at least 25% of the shares of the foreign-invested enterprise for a period greater than 12 months), or otherwise 10%. Whether the favorable rate will be applicable to dividends received by Sinovac Hong Kong from our PRC subsidiaries is subject to the approval of the PRC tax authorities because it is unclear whether Sinovac Hong Kong is considered as the beneficial owner of the dividends in substance. The PRC tax authorities have discretion to assess whether a recipient of the PRC-sourced income is only an agent or a conduit, or lacks the requisite amount of business substance, in which case the application of the tax arrangement may be denied. This withholding tax imposed on dividends paid to us by our PRC subsidiaries would reduce our net income attributable to the shareholders. In May 2012, Sinovac Hong Kong was granted by the local tax bureau the preferential dividend withholding tax rate of 5% on dividends declared by Sinovac Beijing for three years from 2012 to 2014. The State Administration of Taxation has the authority to re-assess the approval of the preferential dividend withholding tax rate granted by the local tax bureau. The preferential dividend withholding tax rate expired in 2014. The dividends received by Sinovac Hong Kong from its PRC subsidiaries are subject to a withholding tax rate of 10%.

B. Significant Changes

Except as disclosed elsewhere in this annual report, we have not experienced any significant changes since the date of our audited consolidated financial statements included in this annual report.

ITEM 9. THE OFFER AND LISTING

A. Offer and Listing Details

The table below sets forth, for the periods indicated, the high and low trading prices on the NASDAQ Global Market and the NASDAQ Global Select Market for our common shares.

| | Trading Price | |
|---------------------------------|---------------|---------|
| | High | Low |
| Annual High and Low | | |
| 2013 | \$ 6.57 | \$ 3.00 |
| 2014 | 8.14 | 4.51 |
| 2015 | 6.18 | 4.56 |
| 2016 | 7.16 | 4.38 |
| 2017 | 8.11 | 4.60 |
| Quarterly High and Low | | |
| First Quarter 2016 | 7.16 | 4.38 |
| Second Quarter 2016 | 6.45 | 5.61 |
| Third Quarter 2016 | 6.01 | 5.50 |
| Fourth Quarter 2016 | 6.45 | 5.25 |
| First Quarter 2017 | 6.05 | 5.50 |
| Second Quarter 2017 | 6.92 | 4.60 |
| Third Quarter 2017 | 7.16 | 6.50 |
| Fourth Quarter 2017 | 8.11 | 6.81 |
| First Quarter 2018 | 8.75 | 7.83 |
| Monthly High and Low | | |
| November 2017 | 7.98 | 6.96 |
| December 2017 | 8.11 | 7.60 |
| January 2018 | 8.67 | 7.83 |
| February 2018 | 8.49 | 7.95 |
| March 2018 | 8.75 | 8.06 |
| April 2018 | 8.59 | 6.65 |
| May 2018 (through May 10, 2018) | 7.83 | 7.22 |

B. Plan of Distribution

Not applicable.

C. Markets

Our common shares have been listed on the NASDAQ Global Select Market since January 3, 2011 under the symbol "SVA."

D. Selling Shareholders

Not applicable.

E. Dilution

Not applicable.

F. Expenses of the Issue

Not applicable.

ITEM 10. ADDITIONAL INFORMATION

A. Share Capital

Not applicable.

B. Memorandum and Articles of Association

We are an Antiguan company with limited liability and our affairs are governed by our Articles of Incorporation, By-laws and the International Business Corporation Act. The following are summaries of material provisions of our Articles of Incorporation, By-laws and the International Business Corporations Act.

General

All of our outstanding common shares are fully paid and non-assessable. The common shares are issued in registered form. Holders of common shares are entitled to receive share certificates. Our shareholders who are non-residents of Antigua may freely hold and vote their common shares.

Dividends

The holders of our common shares are entitled to such dividends as may be declared by our board of directors subject to the International Business Corporations Act.

Voting Rights

Each common share is entitled to one vote on all matters upon which the common shares are entitled to vote.

A quorum required for a meeting of shareholders consists of shareholders who hold at least a majority of our shares at the meeting present in person or by proxy. Shareholders' meetings are held annually and may be convened by our board of directors on its own initiative or upon a request to the directors by shareholders holding in aggregate at least five percent of our issued share capital. Advance notice of at least 21 days is required for the convening of our annual general meeting and other shareholders meetings.

Unless the International Business Corporations Act otherwise requires, resolutions to be passed by the shareholders requires a simple majority vote. Important matters such as changes to our By-laws require a resolution passed by a vote of shareholders holding a majority of all the outstanding and issued shares.

Transfer of Common Shares

Our shareholders may transfer common shares by endorsing the relevant share certificates, completing a share transfer form or by other proper evidence of succession, assignment or authority to transfer.

Liquidation

On a return of capital on winding up or otherwise (other than on conversion, redemption or purchase of common shares), assets available for distribution among the holders of common shares shall be distributed among the holders of the common shares on a pro rata basis. If our assets available for distribution are insufficient to repay all of the paid-up capital, the assets will be distributed so that the losses are borne by our shareholders proportionately.

Inspection of Books and Records

Holders of our common shares will have no general right under Antigua law to inspect or obtain copies of our list of shareholders or our corporate records. They may, however, access such corporate information as is publicly available in the Companies Registry in St. John's, Antigua. We will also provide our shareholders with annual audited consolidated financial statements.

Changes in Capital

We may from time to time by a resolution passed by a majority of the shares entitled to vote:

- increase the share capital by such sum, to be divided into shares of such classes and amount, as the resolution may prescribe;
- consolidate and divide all or any of our share capital into shares of a larger amount than our existing shares;
- sub-divide our existing shares, or any of them into shares of a smaller amount provided that in the subdivision the proportion between the amount paid and the amount, if any unpaid on each reduced share shall be the same as it was in case of the share from which the reduced share is derived; and
- cancel any shares which, at the date of the passing of the resolution, have not been taken or agreed to be taken by any person and diminish the amount of our share capital by the amount of the shares so cancelled.

We may by special resolution reduce our share capital and any capital redemption reserve in any manner authorized by law.

Differences in Corporate Law

The International Business Corporations Act is modeled after English law but does not follow many recent English law statutory enactments. In addition, the International Business Corporations Act differs from laws applicable to United States corporations and their shareholders. Set forth below is a summary of the significant differences between the provisions of the International Business Corporations Law applicable to us and the laws applicable to companies incorporated in the State of Delaware and their stockholders.

Mergers and Similar Arrangements

Antigua and Barbuda law does not provide for mergers as that expression is understood under United States corporate law. However, there are statutory provisions for amalgamation that facilitate the consolidation of companies, provided that the arrangement is approved by a majority number of each class of shareholders and creditors with whom the arrangement is to be made, and who must in addition represent two-thirds in value of each such class of shareholders or creditors, as the case may be, that are present and voting either in person or by proxy at a meeting, or meetings, convened for that purpose. The convening of the meetings and subsequently the arrangement may be, but is not required to be, sanctioned by the High Court of Antigua and Barbuda. While a dissenting shareholder has the right to express to the court his view that the transaction ought not to be approved, the court can be expected to approve the arrangement if it determines that:

- the statutory provisions as to the dual majority vote have been met;
- the shareholders have been fairly represented at the meeting in question;
- the arrangement is such that a businessman would reasonably approve; and
- the arrangement is not one that would more properly be sanctioned under some other provision of the International Business Corporations Act.

When a take-over offer is made and accepted (within four months) by holders of 90% of the shares affected, the offerer may, within a two-month period, require the holders of the remaining shares to transfer such shares on the terms of the offer. An objection can be made to the High Court of Antigua and Barbuda but this is unlikely to succeed unless there is evidence of fraud, bad faith or collusion.

If the arrangement and reconstruction is thus approved, the dissenting shareholder would have no rights comparable to appraisal rights, which would otherwise ordinarily be available to dissenting shareholders of United States corporations, providing rights to receive payment in cash for the judicially determined value of the shares.

Shareholders' Suits

We are not aware of any reported class action or derivative action having been brought in a court in Antigua and Barbuda. In principle, the company itself will normally be the proper claimant in actions against directors, and derivative actions may not generally be brought by a minority shareholder. However, English authorities provide exceptions to the foregoing principle, including when:

- a company acts or proposes to act illegally or ultra vires;
- the act complained of, although not ultra vires, required a special resolution, which was not obtained; and
- those who control the company are perpetrating a “fraud on the minority.”

Directors' Fiduciary Duties

Under Delaware corporate law, a director of a Delaware corporation has a fiduciary duty to the corporation and its shareholders. This duty has two components: the duty of care and the duty of loyalty. The duty of care requires that a director act in good faith, with the care that an ordinarily prudent person would exercise under similar circumstances. Under this duty, a director must inform himself of, and disclose to shareholders, all material information reasonably available regarding a significant transaction. The duty of loyalty requires that a director act in a manner he reasonably believes to be in the best interests of the corporation. He must not use his corporate position for personal gain or advantage. This duty prohibits self-dealing by a director and mandates that the best interest of the corporation and its shareholders take precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the shareholders generally.

In general, actions of a director are presumed to have been made on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the corporation. However, this presumption may be rebutted by evidence of a breach of one of the fiduciary duties. Should such evidence be presented concerning a transaction by a director, a director must prove the procedural fairness of the transaction, and that the transaction was of fair value to the corporation. As a matter of Antigua and Barbuda law, a director of an Antigua and Barbuda company is in the position of a fiduciary with respect to the company and therefore it is considered that he owes the following duties to the company — a duty to act bona fide in the best interests of the company, a duty not to make a profit out of his position as director (unless the company permits him to do so) and a duty not to put himself in a position where the interests of the company conflict with his personal interest or his duty to a third-party.

A director of an Antigua and Barbuda company owes to the company a duty to act with skill and care. It was previously considered that a director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience. However, English and Commonwealth courts have moved towards an objective standard with regard to the required skill and care and these authorities are likely to be followed in Antigua and Barbuda.

Shareholder Action by Written Consent

Under the Delaware General Corporation Law, a corporation may eliminate the right of shareholders to act by written consent by amendment to its certificate of incorporation. Antigua and Barbuda law and our By-laws provide that shareholders may approve corporate matters by way of a unanimous written resolution signed by or on behalf of each shareholder who would have been entitled to vote on such matter at a general meeting without a meeting being held.

Shareholder Proposals

Under the Delaware General Corporation Law, a shareholder has the right to put any proposal before the annual meeting of shareholders, provided it complies with the notice provisions in the governing documents. A special meeting may be called by the board of directors or any other person authorized to do so in the governing documents, but shareholders may be precluded from calling special meetings. Antigua and Barbuda law and our By-laws allow our shareholders holding not less than five per cent of the paid up voting share capital of the company to requisition a shareholder's meeting. We are obligated under our By-laws and the International Business Corporations Act to call shareholders' annual general meetings.

Cumulative Voting

Under the Delaware General Corporation Law, cumulative voting for elections of directors is not permitted unless the corporation's certificate of incorporation specifically provides for it. Cumulative voting potentially facilitates the representation of minority shareholders on a board of directors since it permits the minority shareholder to cast all the votes to which the shareholder is entitled on a single director, which increases the shareholder's voting power with respect to electing such director. As permitted under Antigua and Barbuda law, our By-laws will not provide for cumulative voting. As a result, our shareholders are not afforded any less protections or rights on this issue than shareholders of a Delaware corporation.

Removal of Directors

Under the Delaware General Corporation Law, a director of a corporation with a classified board may be removed only for cause with the approval of a majority of the outstanding shares entitled to vote, unless the certificate of incorporation provides otherwise. Under our By-laws, directors can be removed by a majority vote of the shareholders.

Transactions with Interested Shareholders

The Delaware General Corporation Law contains a business combination statute applicable to Delaware public corporations whereby, unless the corporation has specifically elected not to be governed by such statute by amendment to its certificate of incorporation, it is prohibited from engaging in certain business combinations with an "interested shareholder" for three years following the date that such person becomes an interested shareholder. An interested shareholder generally is a person or a group who or which owns or owned 15% or more of the target's outstanding voting stock within the past three years. This has the effect of limiting the ability of a potential acquirer to make a two-tiered bid for the target in which all shareholders would not be treated equally. The statute does not apply if, among other things, prior to the date on which such shareholder becomes an interested shareholder, the board of directors approves either the business combination or the transaction which resulted in the person becoming an interested shareholder. This encourages any potential acquirer of a Delaware public corporation to negotiate the terms of any acquisition transaction with the target's board of directors.

Antigua and Barbuda law has no comparable statute. As a result, we cannot avail ourselves of the types of protections afforded by the Delaware business combination statute. However, although Antigua and Barbuda law does not regulate transactions between a company and its significant shareholders, it does provide that such transactions must be entered into bona fide in the best interests of the company and not with the effect of constituting a fraud on the minority shareholders.

Dissolution; Winding Up

Under the Delaware General Corporation Law, unless the board of directors approves the proposal to dissolve, dissolution must be approved by shareholders holding 100% of the total voting power of the corporation. Only if the dissolution is initiated by the board of directors may it be approved by a simple majority of the corporation's outstanding shares. Delaware law allows a Delaware corporation to include in its certificate of incorporation a supermajority voting requirement in connection with dissolutions initiated by the board. Under the International Business Corporations Law, our company may be dissolved, liquidated or wound up only by the vote of holders of two-thirds of our shares voting at a meeting or the unanimous written resolution of all shareholders.

Variation of Rights of Shares

Under the Delaware General Corporation Law, a corporation may vary the rights of a class of shares with the approval of a majority of the outstanding shares of such class, unless the certificate of incorporation provides otherwise. Under Antigua and Barbuda law and our By-laws, if our share capital is divided into more than one class of shares, we may vary the rights attached to any class only with the vote at a class meeting of holders of two-thirds of the shares of such class or unanimous written resolution.

Amendment of Governing Documents

Under the Delaware General Corporation Law, a corporation's governing documents may be amended with the approval of a majority of the outstanding shares entitled to vote, unless the certificate of incorporation provides otherwise. As permitted by Antigua and Barbuda law, our By-laws may only be amended with the vote of holders representing a majority of all our shares voting issued and outstanding or the unanimous written resolution of all shareholders. By-laws can be amended by a vote or unanimous written resolution of the directors.

Indemnification of Directors and Executive Officers and Limitation of Liability

Antigua and Barbuda law does not limit the extent to which a company's by-laws may provide for indemnification of officers and directors, except to the extent any such provision may be held by the Antigua and Barbuda courts to be contrary to public policy, such as to provide indemnification against civil fraud or the consequences of committing a crime. Our By-laws permit indemnification of officers and directors for losses, damages, costs and expenses incurred in their capacities as such unless such losses or damages arise from negligence or illegal action of such directors or officers. This standard of conduct is generally the same as permitted under the Delaware General Corporation Law to a Delaware corporation. In addition, we have entered into indemnification agreements with our directors and senior executive officers that provide such persons with additional indemnification beyond that provided in our By-laws.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to our directors, officers or persons controlling us under the foregoing provisions, we have been informed that in the opinion of the SEC such indemnification is against public policy as expressed in the Securities Act and is therefore unenforceable as a matter of United States law.

We have obtained directors and officers insurance providing indemnification for our directors for certain liabilities.

Anti-takeover Provisions in the By-laws

Some provisions of our By-laws may discourage, delay or prevent a change in control of our company or management that shareholders may consider favorable, including provisions that authorize our board of directors to issue preferred shares in one or more series and to designate the price, rights, preferences, privileges and restrictions of such preferred shares without any further vote or action by our shareholders.

However, under Antigua and Barbuda law, our directors may only exercise the rights and powers granted to them under our By-laws for what they believe in good faith to be in the best interests of our company.

Rights of Non-resident or Foreign Shareholders

There are no limitations imposed by our By-laws on the rights of non-resident or foreign shareholders to hold or exercise voting rights on our shares. In addition, there are no provisions in our By-laws governing the ownership threshold above which shareholder ownership must be disclosed.

C. Material Contracts

We have not entered into any material contracts other than in the ordinary course of business and other than those described in "Item 4. Information on the Company" or elsewhere in this annual report on Form 20-F.

D. Exchange Controls

Foreign Currency Exchange

Pursuant to the Foreign Currency Administration Rules promulgated in 1996 and amended in 1997 and various regulations issued by SAFE and other relevant PRC government authorities, renminbi is freely convertible only to the extent of current account items, such as trade related receipts and payments, interest and dividends. Capital account items, such as direct equity investments, loans and repatriation of investment, require the prior approval from SAFE or its local counterpart for conversion of renminbi into a foreign currency, such as U.S. dollars, and remittance of the foreign currency outside the PRC.

Payments for transactions that take place within PRC must be made in renminbi. Unless otherwise approved, PRC companies must repatriate foreign currency payments received from abroad. Foreign-invested enterprises may retain foreign exchange in accounts with designated foreign exchange banks subject to a cap set by SAFE or its local counterpart. Unless otherwise approved, domestic enterprises must convert all of their foreign currency receipts into renminbi.

E. Taxation

Antigua and Barbuda Taxation

We and our securities holders, other than those resident in Antigua and Barbuda, are exempt from Antigua and Barbuda income, corporation or profits tax, withholding tax, capital gains tax, capital transfer tax, estate duty or inheritance tax. We are not subject to stamp or other similar duty on the issuance, transfer or redemption of our common shares. Under Section 276 of the International Business Corporations Act of Antigua and Barbuda, the tax exemption we and our securities holders currently enjoy will continue in effect for a period of 50 years from our date of incorporation, which is March 1, 1999. No reciprocal income tax treaty affecting us exists between Antigua and Barbuda and the United States.

United States Federal Income Taxation

The following discussion describes the material U.S. federal income tax consequences to U.S. Holders (as defined below) under current law of an investment in our common shares. The effects of any applicable state or local laws and other U.S. federal tax laws such as estate and gift tax laws, and the impact of the alternative minimum tax and the Medicare contribution tax on net investment income, are not discussed. This discussion applies only to U.S. Holders that hold our common shares as capital assets (generally, property held for investment) and have the U.S. dollar as their functional currency. This discussion is based on the tax laws of the United States as in effect on the date of this annual report and on U.S. Treasury regulations in effect or, in some cases, proposed as of the date of this annual report, as well as judicial and administrative interpretations thereof available on or before such date. All of the foregoing authorities are subject to change, which change could apply retroactively and could affect the tax consequences described below. The following discussion does not address all U.S. federal income tax consequences relevant to a U.S. Holder's particular circumstances or to holders subject to particular rules, including:

- banks and other financial institutions;
- insurance companies;
- regulated investment companies;
- real estate investment trusts;
- broker-dealers;
- traders that elect to use a mark-to-market method of accounting;
- U.S. expatriates;
- tax-exempt entities;
- persons holding a common share as part of a straddle, hedging, conversion or integrated transaction;
- persons that actually or constructively own 10% or more of our stock by vote or value;
- persons subject to special tax accounting rules as a result of any item of gross income with respect to our common shares being taken into account in an "applicable financial statement" (as defined in the U.S. Internal Revenue Code of 1986, as amended);
- partnerships or other pass-through entities, or persons holding our common shares through such entities; or
- persons who acquired our common shares pursuant to the exercise of any employee share option or otherwise as compensation.

INVESTORS ARE URGED TO CONSULT THEIR TAX ADVISORS REGARDING THE APPLICATION OF THE U.S. FEDERAL INCOME TAX RULES TO THEIR PARTICULAR CIRCUMSTANCES AS WELL AS THE ESTATE AND GIFT, STATE, LOCAL AND FOREIGN TAX CONSEQUENCES TO THEM OF THE PURCHASE, OWNERSHIP AND DISPOSITION OF OUR COMMON SHARES.

The discussion below of the U.S. federal income tax consequences to “U.S. Holders” will apply to you if you are a beneficial owner of our common shares and you are, for U.S. federal income tax purposes:

- an individual who is a citizen or resident of the United States;
- a corporation (or other entity taxable as a corporation for U.S. federal income tax purposes) created or organized under the laws of the United States, any state thereof or the District of Columbia;
- an estate, the income of which is subject to U.S. federal income taxation regardless of its source; or
- a trust that (1) is subject to the primary supervision of a court within the United States and the control of one or more U.S. persons for all substantial decisions or (2) has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

If a partnership (or other entity taxable as a partnership for U.S. federal income tax purposes) is a beneficial owner of our common shares, the tax treatment of a partner in the partnership generally will depend upon the status of the partner and the activities of the partnership. If you are a partner in such partnership, you should consult your tax advisor.

Taxation of Dividends and Other Distributions on Our Common Shares

Subject to the PFIC rules discussed below, the gross amount of any distributions we make to you with respect to our common shares generally will be includible in your gross income in the year received as dividend income to the extent the distribution is paid out of our current or accumulated earnings and profits (as determined under U.S. federal income tax principles). To the extent the amount of the distribution exceeds our current and accumulated earnings and profits, such excess amount will be treated first as a tax-free return of your tax basis in your common shares, and then, to the extent such excess amount exceeds your tax basis, as capital gain. We currently do not, and we do not intend to, calculate our earnings and profits under U.S. federal income tax principles. Therefore, a U.S. Holder should expect that a distribution will generally be reported as a dividend even if that distribution would otherwise be treated as a non-taxable return of capital or as capital gain under the rules described above. Any dividends we pay will not be eligible for the dividends-received deduction allowed to corporations in respect of dividends received from U.S. corporations.

With respect to certain non-corporate U.S. Holders, including individual U.S. Holders, dividends may constitute “qualified dividend income” eligible to be taxed at the preferential rate applicable to capital gains, provided that (1) our common shares are readily tradable on an established securities market in the United States, or we are eligible for the benefits of a qualifying income tax treaty with the United States that includes an exchange of information program, (2) we are neither a PFIC nor treated as such with respect to you (as discussed below) for the taxable year in which the dividend is paid or the preceding taxable year and (3) certain holding period requirements are met. Under U.S. Internal Revenue Service authority, common shares are considered for the purpose of clause (1) above to be readily tradable on an established securities market in the United States if they are listed on the NASDAQ Global Select Market, as are our common shares. There can be no assurance our common shares will continue to be readily tradable on an established securities market in later years. Consequently, there can be no assurance dividends paid on our common shares will continue to qualify for the reduced tax rates. If we are treated as a “resident enterprise” for PRC tax purposes under the EIT Law (see “Item 10. Additional Information — E. Taxation — PRC Taxation”), we may be eligible for the benefits of the income tax treaty between the United States and the PRC. You should consult your tax advisors regarding the availability of the lower capital gains rate applicable to qualified dividend income for dividends paid with respect to our common shares.

Dividends generally will constitute foreign source income for foreign tax credit limitation purposes. If the dividends are taxed as qualified dividend income (as discussed above), the amount of the dividend taken into account for purposes of calculating the U.S. foreign tax credit limitation generally will be limited to the gross amount of the dividend, multiplied by the reduced tax rate applicable to qualified dividend income and divided by the highest tax rate that would be applicable to dividends if not for the reduced tax rate applicable to qualified dividend income. The limitation on foreign taxes eligible for credit is calculated separately with respect to specific classes of income. For this purpose, dividends distributed by us with respect to our common shares generally will constitute “passive category income.”

If PRC withholding taxes apply to dividends paid to you with respect to the common shares (see “Item 10. Additional Information — E. Taxation — PRC Taxation”), subject to certain conditions and limitations, such PRC withholding taxes may be treated as foreign taxes eligible for credit against your U.S. federal income tax liability. The rules relating to the determination of the foreign tax credit are complex, and you should consult your tax advisors regarding the availability of a foreign tax credit in your particular circumstances.

Taxation of Disposition of Our Common Shares

Subject to the PFIC rules discussed below, you will recognize taxable gain or loss on any sale, exchange or other taxable disposition of a common share equal to the difference between the amount realized for the common share and your tax basis in the common share. Your tax basis in our common shares will generally equal the cost of such shares. The gain or loss generally will be capital gain or loss. If you are a non-corporate U.S. Holder, including an individual U.S. Holder, who has held the common share for more than one year, you will be eligible for reduced tax rates. The deductibility of capital losses is subject to limitations.

Any gain or loss you recognize on a disposition of our common shares generally will be treated as U.S. source income or loss for foreign tax credit limitation purposes. However, if we are treated as a resident enterprise for PRC tax purposes and PRC tax may be imposed on any gain from the disposition of the common shares in accordance with the income tax treaty between the United States and the PRC (see “Item 10. Additional Information — E. Taxation — PRC Taxation”), a U.S. Holder that is eligible for the benefits of the income tax treaty between the United States and the PRC may elect to treat the gain as PRC source income. You should consult your tax advisors regarding the proper treatment of gain or loss in your particular circumstances.

Passive Foreign Investment Company

Based on the market price of our common shares, the value of our assets, and the composition of our income and assets, we do not believe we were a PFIC for U.S. federal income tax purposes for our taxable year ended December 31, 2017. However, the application of the PFIC rules is subject to uncertainty in several respects, and we cannot assure you we will not be a PFIC for any taxable year.

A non-U.S. corporation will be a PFIC for any taxable year if either:

- at least 75% of its gross income for such year is passive income, or
- at least 50% of the value of its assets (based on a quarterly average) during such year is attributable to assets that produce passive income or are held for the production of passive income.

For purposes of the PFIC rules, passive income includes, among other things, dividends, interest, royalties, rents, annuities, and net gains from certain commodity and foreign currency transactions, subject to certain exceptions. Passive income generally does not include rents and royalties derived from the active conduct of a trade or business (other than from a related person). We will be treated as owning our proportionate share of the assets and earning our proportionate share of the income of any other corporation in which we own, directly or indirectly, at least 25% (by value) of the stock.

We must make a separate determination after the close of each year as to whether we were a PFIC for that year. The composition of our income and assets will be affected by how, and how quickly, we use any cash we generate from our operations or raise in any offering. Because the value of our assets for purposes of the PFIC test will generally be determined by reference to the market price of our common shares, fluctuations in the market price of our common shares may cause us to become a PFIC for any subsequent year. If we are a PFIC for any year during which you hold our common shares, we generally will continue to be treated as a PFIC with respect to you for that year and for all succeeding years during which you hold our common shares, unless we cease to be a PFIC and you make a “deemed sale” election with respect to our common shares. If such election is made, you will be deemed to have sold common shares you hold at their fair market value on the last day of the last taxable year in which we qualified as a PFIC, and any gain from such deemed sale would be subject to the rules described in the following two paragraphs. After the deemed sale election, your common shares with respect to which such election was made will not be treated as shares in a PFIC unless we subsequently become a PFIC. You are urged to consult your tax advisor about this election.

For each taxable year we are treated as a PFIC with respect to you, you will be subject to special tax rules with respect to any “excess distribution” you receive and any gain you recognize from a sale or other disposition (including a pledge) of the common shares, unless you make a “mark-to-market” election as discussed below. Distributions you receive in a taxable year that are greater than 125% of the average annual distributions you received during the shorter of the three preceding taxable years or your holding period for the common shares before the current year will be treated as an excess distribution. Under these special tax rules:

- the excess distribution or recognized gain will be allocated ratably over your holding period for the common shares;
- the amount allocated to the current taxable year, and any taxable years in your holding period prior to the first taxable year in which we became a PFIC, will be treated as ordinary income; and
- the amount allocated to each other year will be subject to tax at the highest income tax rate in effect for individuals or corporations, as applicable, for each such year, and the interest charge generally applicable to underpayments of tax will be imposed on the resulting tax attributable to each such year.

The tax liability for amounts allocated to years prior to the year of disposition or excess distribution cannot be offset by any net operating losses for such years, and gains (but not losses) from a sale or other disposition of the common shares are not taxed at reduced tax rates, even if you hold the common shares as capital assets.

If we are treated as a PFIC with respect to you for any taxable year, to the extent any of our subsidiaries are also PFICs or we make direct or indirect equity investments in other entities that are PFICs, you will be deemed to own shares in such lower-tier PFICs directly or indirectly owned by us in the proportion that the value of the common shares you own bears to the value of all of our common shares, and you may be subject to the rules described in the preceding two paragraphs with respect to the shares of such lower-tier PFICs that you would be deemed to own. You should consult your tax advisors regarding the application of the PFIC rules to any of our subsidiaries.

A U.S. Holder of marketable stock (as defined below) in a PFIC may make a mark-to-market election for such stock to elect out of the PFIC rules described above regarding excess distributions and recognized gains. If you make a mark-to-market election for the common shares, you will include in income for each year that we are a PFIC an amount equal to the excess, if any, of the fair market value of the common shares as of the close of your taxable year over your adjusted basis in such common shares. You will be allowed a deduction for the excess, if any, of the adjusted basis of the common shares over their fair market value as of the close of the taxable year. However, deductions will be allowable only to the extent of any net mark-to-market gains on the common shares included in your income for prior taxable years. Amounts included in your income under a mark-to-market election, as well as gain from the actual sale or other disposition of the common shares will be treated as ordinary income. Ordinary loss treatment will apply to the deductible portion of any mark-to-market loss on the common shares, as well as to any loss from the actual sale or other disposition of the common shares, to the extent that the amount of such loss does not exceed the net mark-to-market gains previously included for such common shares. Your basis in the common shares will be adjusted to reflect any such income or loss amounts. If you make a valid mark-to-market election, any distributions we make would generally be subject to the tax rules discussed above under “— Taxation of Dividends and Other Distributions on Our Common Shares,” and the lower capital gains rate applicable to qualified dividend income would not apply.

The mark-to-market election is available only for “marketable stock,” which generally is defined as stock that is traded in greater than de minimis quantities on at least 15 days during each calendar quarter (“regularly traded”) on a qualified exchange or other market, as defined in applicable U.S. Treasury regulations. Our common shares are listed on the NASDAQ Global Select Market, which is a qualified exchange or other market for these purposes. Consequently, if the common shares remain listed on the NASDAQ Global Select Market and are regularly traded, and you are a holder of common shares, we expect the mark-to-market election would be available to you if we become a PFIC. There can be no assurance the common shares will be “regularly traded” for purposes of the mark-to-market election. Because a mark-to-market election cannot be made for equity interests in any lower-tier PFICs that we own, a U.S. Holder may continue to be subject to the PFIC rules described above regarding excess distributions and recognized gains with respect to its indirect interest in any investments held by us that are treated as an equity interest in a PFIC for U.S. federal income tax purposes. You should consult your tax advisors as to the availability and desirability of a mark-to-market election, as well as the impact of such election on interests in any lower-tier PFICs.

Alternatively, a U.S. Holder of stock in a PFIC may make a “qualified electing fund” election with respect to such corporation to elect out of the PFIC rules described above regarding excess distributions and recognized gains. A U.S. Holder that makes a qualified electing fund election with respect to a PFIC will generally include in income such holder’s pro rata share of the corporation’s income on a current basis. However, you may make a qualified electing fund election with respect to your common shares only if we furnish you annually with certain tax information, and we currently do not intend to prepare or provide such information.

Each U.S. shareholder of a PFIC is required to file an annual report containing such information as the U.S. Treasury requires. If we become a PFIC, you should consult your tax advisors regarding any reporting requirements that may apply to you.

You are urged to consult your tax advisors regarding the application of the PFIC rules to your investment in our common shares.

Information Reporting and Backup Withholding

Dividend payments with respect to our common shares and proceeds from the sale, exchange or redemption of our common shares may be subject to information reporting to the U.S. Internal Revenue Service and possible U.S. backup withholding at a current rate of 24%. Backup withholding will not apply, however, to a U.S. Holder that furnishes a correct taxpayer identification number and makes any other required certification on U.S. Internal Revenue Service Form W-9 or that is otherwise exempt from backup withholding. U.S. Holders that are required to establish their exempt status generally must provide such certification on U.S. Internal Revenue Service Form W-9. U.S. Holders should consult their tax advisors regarding the application of the U.S. information reporting and backup withholding rules.

Backup withholding is not an additional tax. Amounts withheld as backup withholding may be credited against your U.S. federal income tax liability, and you may obtain a refund of any excess amounts withheld under the backup withholding rules by filing the appropriate claim for refund with the U.S. Internal Revenue Service and furnishing any required information in a timely manner.

Additional Reporting Requirements

Certain U.S. Holders who are individuals are required to report information relating to an interest in our common shares, subject to certain exceptions (including an exception for common shares held in accounts maintained by certain financial institutions). U.S. Holders should consult their tax advisors regarding the effect, if any, of these rules on their ownership and disposition of our common shares.

PRC Taxation

Under the EIT Law, enterprises established under the laws of non-PRC jurisdictions but whose “de facto management body” is located in China are considered “resident enterprises” for PRC tax purposes. Under the implementation regulations issued by the State Council relating to the EIT Law, “de facto management bodies” are defined as the bodies that have material and overall management control over the business, personnel, accounts and properties of an enterprise. In 2009, the State Administration of Taxation issued a circular, known as Circular 82, which provides certain specific criteria for determining whether the “de facto management body” of a PRC-controlled offshore incorporated enterprise is located in China. Although this circular only applies to offshore enterprises controlled by PRC enterprises or PRC enterprise groups, not those controlled by PRC individuals or foreigners, the criteria set forth in the circular may reflect the State Administration of Taxation’s general position on how the “de facto management body” text should be applied in determining the tax resident status of all offshore enterprises. According to Circular 82, an offshore incorporated enterprise controlled by a PRC enterprise or a PRC enterprise group will be regarded as a PRC tax resident by virtue of having its “de facto management body” in China only if all of the following conditions are met: (i) the primary location of the day-to-day operational management is in the PRC; (ii) decisions relating to the enterprise’s financial and human resource matters are made or are subject to approval by organizations or personnel in the PRC; (iii) the enterprise’s primary assets, accounting books and records, company seals, and board and shareholders minutes, are located or maintained in the PRC; and (iv) at least 50% of voting board members or senior executives habitually reside in the PRC. Substantially all of our management are currently based in China, and may remain in China in the future. If we were treated as a “resident enterprise” for PRC tax purposes, we would be subject to PRC income tax on our worldwide income at a uniform tax rate of 25%. Dividends received by us from our PRC subsidiaries may be exempt from PRC withholding tax.

Under the EIT Law and its implementation regulations, dividends paid to a non-PRC investor are generally subject to a 10% PRC withholding tax, if such dividends are derived from sources within China and the non-PRC investor is considered to be a non-resident enterprise without any establishment or place of business within China or if the dividends paid have no connection with the non-PRC investor's establishment or place of business within China, unless such tax is eliminated or reduced under an applicable tax treaty. Similarly, any gain realized on the transfer of common shares by such investor is also subject to a 10% PRC withholding tax if such gain is regarded as income derived from sources within China, unless such tax is eliminated or reduced under an applicable tax treaty.

If we were considered a PRC "resident enterprise," it is possible that the dividends we pay with respect to our common shares, or the gain you may realize from the transfer of our common shares, would be treated as income derived from sources within China and be subject to income tax at 10%.

F. Dividends and Paying Agents

Not applicable.

G. Statement by Experts

Not applicable.

H. Documents on Display

We are subject to the periodic reporting and other informational requirements of the Exchange Act. Under the Exchange Act, we are required to file reports and other information with the SEC. Specifically, we are required to file annually a Form 20-F within four months after the end of each fiscal year. Copies of reports and other information, when so filed, may be inspected without charge and may be obtained at prescribed rates at the public reference facilities maintained by the SEC at Judiciary Plaza, 100 F Street, N.E., Washington, D.C. 20549, and at the regional office of the SEC located at Citicorp Center, 500 West Madison Street, Suite 1400, Chicago, Illinois 60661. The public may obtain information regarding the Washington, D.C. Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains a web site at www.sec.gov that contains reports, proxy and information statements, and other information regarding registrants that make electronic filings with the SEC using its EDGAR system. As a foreign private issuer, we are exempt from the rules under the Exchange Act prescribing the furnishing and content of quarterly reports and proxy statements, and officers, directors and principal shareholders are exempt from the reporting and short-swing profit recovery provisions contained in Section 16 of the Exchange Act.

We will furnish the transfer agent of our common shares, with our annual reports, which will include a review of operations and annual audited consolidated financial statements prepared in conformity with U.S. GAAP, and all notices of shareholders' meetings and other reports and communications that are made generally available to our shareholders. The transfer agent will make such notices, reports and communications available to holders of our common shares and, upon our request, will mail to all record holders of our common shares the information contained in any notice of a shareholders' meeting received by the transfer agent from us.

In accordance with the NASDAQ Rules, we will post this annual report on Form 20-F on our website www.sinovac.com. In addition, we will provide hardcopies of our annual report free of charge to shareholders upon request.

I. Subsidiary Information

For a listing of our subsidiaries, see "Item 4. Information on the Company — C. Organizational Structure."

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Exchange Risk

Substantially all of our revenues and most of our costs and our expenses are denominated in renminbi. Our exposure to foreign exchange risk primarily relates to cash and cash equivalents denominated in U.S. dollars as a result of our past issuances of common shares through a private placement and proceeds from our public offering of common shares. Furthermore, the renminbi prices of some of the materials and supplies for reagent kits that are imported from companies in the United States, Sweden and United Kingdom may be affected by fluctuations in the value of renminbi against the currencies of those countries. We also incur professional, investor relations, director compensation and miscellaneous fees related to our operations as a public company that are denominated in U.S. dollars.

The value of the renminbi against the U.S. dollar and other currencies may fluctuate and is affected by, among other things, changes in China's political and economic conditions. The conversion of renminbi into foreign currencies, including U.S. dollars, has been based on rates set by the People's Bank of China. In July 2005, the PRC government changed its decades-old policy of pegging the value of renminbi to U.S. dollars, and renminbi appreciated more than 20% against U.S. dollars over the following three years. Between July 2008 and June 2010, this appreciation subsided and the exchange rate between renminbi and U.S. dollars remained within a narrow band. Since June 2010, renminbi has fluctuated against U.S. dollars, at times significantly and unpredictably. It is difficult to predict how market forces or PRC or U.S. government policy may impact the exchange rate between renminbi and U.S. dollar in the future. The PRC government has indicated that it will make effort to widen the trading band of the renminbi exchange rate, which increases the possibility of sharp fluctuations in renminbi's value in the future as well as the unpredictability associated with renminbi's exchange rate. By way of example, assuming we had converted a U.S. dollar denominated cash balance of \$1.0 million as of December 31, 2017 into renminbi at the exchange rate of \$1.00 for RMB6.5063 as of December 31, 2017, such a cash balance would have been RMB6.51 million. Assuming a 1% appreciation/depreciation of the renminbi against the U.S. dollar, such a cash balance would have decreased/increased by RMB65,063 as of December 31, 2017.

Our financial statements are expressed in U.S. dollars but our subsidiaries' functional currency is renminbi. The value of our shares will be affected by the foreign exchange rate between U.S. dollars and renminbi. To the extent we hold assets denominated in U.S. dollars, any appreciation of the renminbi against the U.S. dollar could result in a change to our statements of comprehensive income and a reduction in the value of our U.S. dollar denominated assets. On the other hand, a decline in the value of renminbi against the U.S. dollar could reduce the U.S. dollar equivalent amounts of our financial results, the value of your investment in our company and the dividends we may pay in the future, if any, all of which may have a material adverse effect on the prices of our shares.

Interest Rate Risk

Our exposure to interest rate risk relates primarily to the interest expense associated with our short-term and/or long-term bank borrowings as well as interest income provided by excess cash invested in demand and term deposits. Such borrowing and interest-earning instruments carry a degree of interest rate risk. We have not historically used, and do not expect to use in the future, any derivative financial instruments to manage our exposure to interest risk. We have not been exposed nor do we anticipate being exposed to material risks due to changes in interest rates. The weighted effective interest rate on our outstanding loans was 4.61%, 4.73% and 4.83% for the years ended December 31, 2017, 2016 and 2015. A hypothetical increase or decrease in interest rates of 1% would increase or decrease our annual interest and financing expenses by \$0.3 million based on our outstanding indebtedness as of December 31, 2017.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not applicable.

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

None.

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

A. — D. Material Modifications to the Rights of Security Holders

In March 2016, we adopted our Rights Plan. Pursuant to our Rights Plan, subject to limited exceptions, upon (i) a person or group obtaining ownership of 15% or more of our common shares or (ii) the commencement or announcement of an intention to make a tender offer or exchange offer, the consummation of which would result in the beneficial ownership by a person or group of 15% or more of our common shares, in each case, without the approval of our board of directors, each Right will entitle the holders, other than the Acquiring Person, to buy, at an exercise price of \$30.00, one one-thousandth of a Series A Preferred Share. Holders are entitled to receive, in lieu of each one one-thousandths of a Series A Preferred Share, common shares having a market value at that time of twice the Right's exercise price. Our board of directors is entitled to redeem the Rights at \$0.001 per Right at any time before the Rights are exercisable. In March 2017, we amended our Rights Plan to extend its term for a 12-month period. In June 2017, we amended our Rights Plan in connection with the execution of the Amalgamation Agreement.

E. Use of Proceeds

On February 2, 2010, we completed a follow-on public offering of our common shares. In this follow-on offering, we issued and sold an aggregate of 11,500,000 common shares at \$5.75 per share. The common shares offered and sold were registered pursuant to the registration statement on Form F-3 (File Number: 333-163165) effective on November 30, 2010 and the registration statement on Form F-3 (File Number: 333-164559) effective on January 27, 2010. UBS Securities LLC and Piper Jaffray & Co. were the representatives of the underwriters of the offering. We received net proceeds of approximately \$61.8 million, after deducting underwriting discounts and commissions and estimated offering expenses payable by us. We have invested approximately \$29.2 million in Sinovac Dalian and invested \$26.8 million in Sinovac R&D to conduct research and development and other operating activities of operational entities in PRC.

We have used the remaining net proceeds we received from this offering for the following purposes:

- research and development of our product candidates; and
- other general corporate purposes.

The foregoing use of our net proceeds received from the offering represents our current intentions based upon our present plans and business condition. The amounts and timing of any expenditure will vary depending on the amount of cash generated by our operations, competitive and technological developments and the rate of growth, if any, of our business. Accordingly, our management will have significant discretion in the allocation of the net proceeds we received from this offering. Depending on future events and other changes in the business climate, we may determine at a later time to use the net proceeds for different purposes, including repayment of certain of our outstanding bank borrowings. Pending the use of the net proceeds, we intend to invest the net proceeds in a variety of capital preservation instruments, including short-term, investment-grade, interest-bearing instruments.

ITEM 15. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

In connection with the preparation of this annual report on Form 20-F, we carried out an evaluation of the effectiveness of our disclosure controls and procedures, which is defined in Rules 13a-15(e) of the Exchange Act, as of the period covered by this annual report.

Based on this evaluation, our chief executive officer and chief financial officer concluded that, as of December 31, 2017, our disclosure controls and procedures were effective in ensuring that the information required to be disclosed by us in the reports that we file or submit under the Exchange Act was recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and that the information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our chief executive officer and chief financial officer, to allow timely decisions regarding required disclosure.

Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, which is defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act. Our internal control system was designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation and fair presentation of the consolidated financial statements for external purposes in accordance with accounting principles generally accepted in the United States and includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of a company's assets, (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with generally accepted accounting principles, and that a company's receipts and expenditures are made only in accordance with authorization of a company's management and directors, and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of a company's assets that could have a material effect on the consolidated financial statements.

Our management conducted an assessment of the effectiveness of our internal control over financial reporting as of December 31, 2017. In making this assessment, we used the criteria established within the *Internal Control—Integrated Framework (2013 Framework)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. This evaluation included a review of the documentation of controls, an evaluation of the design effectiveness of controls, the testing of the operating effectiveness of controls and a conclusion on this evaluation. All internal control systems, no matter how well designed, have inherent limitations. Even those systems determined to be effective may not prevent or detect misstatements and can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement to our annual or interim financial statements will not be prevented or detected on a timely basis.

Based on our evaluation, our management has concluded that our internal control over financial reporting was effective as of December 31, 2017.

Ernst & Young Hua Ming LLP, an independent registered public accounting firm that audited the financial statements included in this annual report, has issued an attestation report on the effectiveness of our internal control over financial reporting.

Attestation Report of the Registered Public Accounting Firm

The attestation report issued by Ernst & Young Hua Ming LLP, our independent registered public accounting firm, on the effectiveness of internal control over financial reporting can be found on page F-4 of this annual report.

Changes in Internal Control over Financial Reporting

As previously reported, we identified the material weakness as of December 31, 2016 related to: (i) lack of design of effective controls to identify, assess and review provision of non-routine benefits for employees and the related individual income tax withholding obligations, and (ii) ineffective design of controls over the expense authorization and reimbursement process to obtain adequate supporting documentation to facilitate review and approval of expenses and to evaluate the nature of such expenses in order to (i) assess corresponding corporate income tax impacts, if any, and (ii) prevent or detect possible non-compliance with anti-bribery and bookkeeping provisions of the Foreign Corrupt Practices Act, which has been subsequently remedied in 2017.

We implemented a number of changes in our internal control over financial reporting during the year ended December 31, 2017. As of December 31, 2017, we have fully remediated the aforementioned material weakness in our internal control over financial reporting.

Our remedial actions for the material weakness in relation to our assessment on the non-routine benefits for employees included the following:

- ÿ Enhanced pre-approval protocols of non-routine employee benefits and establish procedures to ensure timely communication of such benefits between our business department, human resource department and financial department;
- ÿ Trained and educated our human resource and tax personnel on the taxation requirements on the individual income tax assessment over non-routine benefits provided to employees;
- ÿ Strengthened our internal audit testing function to evaluate the operating effectiveness of the controls to be implemented over assessment of individual income tax related to non-routine benefits provided to employees.

Our remedial actions for the material weakness in relation to our expense authorization and reimbursement process included the following:

- ÿ Established new risk management and compliance functions, including a Risk Management Committee and a Sales Risk Management Group, provided oversight on operational risk management, including but not limited to sales related activities;
- ÿ Established gift and entertainment policies and procedures with detailed requirements in terms of types of gifts and entertainment activities, thresholds, approvals and documentation. Implemented more rigorous expense authorization and approval controls to prevent and detect possible non-compliance with anti-bribery and bookkeeping provisions of the Foreign Corrupt Practices Act;
- ÿ Trained and educated our personnel on corporate income tax requirements over business expenses, in particular gift and entertainment expenses, as well as the Foreign Corrupt Practices Act compliance related issues;
- ÿ Strengthened our internal audit testing function to evaluate the employee compliance with gift and entertainment policies, as well as to evaluate the operating effectiveness of the controls to be implemented over the review, approval and documentation of expense application and reimbursement process.

As required by Rule 13a-15(d), under the Exchange Act, our management, including our chief executive officer and chief financial officer, has conducted an evaluation of our internal control over financial reporting to determine whether any changes occurred during the period covered since last report have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Based on this evaluation, except as described above, it has been determined that there has been no change during the period covered by this annual report that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Our management will continue to work to strengthen our internal controls over financial reporting.

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our board of directors has determined that we have at least one audit committee financial expert serving on our audit committee. Our audit committee financial expert is Mr. Simon Anderson. Each member of our audit committee, including Mr. Anderson, satisfies the “independence” requirements of the NASDAQ Marketplace rule and Rule 10A-3 under the Exchange Act.

ITEM 16B. CODE OF ETHICS

Our board of directors has adopted a code of ethics that applies to our directors, officers, employees and agents, including certain provisions that specifically apply to our chief executive officer, chief financial officer, vice presidents and any other persons who perform similar functions for us. We have filed our code of business conduct and ethics as an exhibit our annual report on Form 20-F (file no. 001-32371) filed with the SEC on July 14, 2006, and posted the code on our website at www.sinovac.com. We hereby undertake to provide to any person without charge, a copy of our code of business conduct and ethics within ten working days after we receive such person’s written request.

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following table sets forth the aggregate fees by categories specified below in connection with certain professional services rendered by Ernst & Young Hua Ming LLP, for the periods indicated below.

| | <u>2017</u> | <u>2016</u> |
|-------------------------------------|---------------|---------------|
| Audit fees ⁽¹⁾ | \$1.3 million | \$0.7 million |
| Audited-related fees ⁽²⁾ | — | — |
| Tax fees ⁽³⁾ | — | — |
| All other fees ⁽⁴⁾ | — | — |

(1) “Audit fees” means the aggregate fees billed in each of the fiscal years listed for professional services rendered by our principal auditors for the audit of our annual financial statements included in our annual reports on Form 20-F or services that are normally provided by accountants in connection with statutory and regulatory engagements for those fiscal years.

(2) “Audit-related fees” means the aggregate fees billed in each of the fiscal years listed for assurance and related services rendered by our principal auditors that are reasonably related to the performance of the audit of our financial statements and are not reported under “Audit fees.”

(3) “Tax fees” means the aggregate fees billed in each of the fiscal years listed for professional services rendered by our principal auditors for tax compliance, tax advice, and tax planning.

(4) “All other fees” means the aggregate fees billed in each of the fiscal years listed for products and services provided by our principal accountant, other than the services reported in the other categories.

Before our independent auditors are engaged to render any services, the terms and fees of the engagement are reviewed by the audit committee before our audit committee grants approval. All services as described above have been approved by our audit committee.

ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

None.

ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

None.

ITEM 16F. CHANGE IN REGISTRANT’S CERTIFYING ACCOUNTANT

None.

ITEM 16G. CORPORATE GOVERNANCE

NASDAQ Stock Market Rule 5620 requires each issuer to hold an annual meeting of shareholders no later than one year after the end of the issuer’s fiscal year-end. However, NASDAQ Stock Market Rule 5615(a)(3) permits foreign private issuers like us to follow “home country practice” in certain corporate governance matters. We did not have an annual meeting of shareholders in 2017 and held an annual meeting of shareholders on February 6, 2018. Delany Law, our Antigua and Barbuda counsel, has provided a letter to the NASDAQ Stock Market certifying that our current practice relating to the annual meeting of shareholders will not breach our Articles of Incorporation and By-laws nor any applicable law in Antigua and Barbuda.

Other than the annual meeting practice described above, there are no significant differences between our corporate governance practices and those followed by U.S. domestic companies under NASDAQ Stock Market Rules.

ITEM 16H. MINE SAFETY DISCLOSURE

Not applicable.

PART III**ITEM 17. FINANCIAL STATEMENTS**

We have elected to provide financial statements pursuant to Item 18.

ITEM 18. FINANCIAL STATEMENTS

The consolidated financial statements of our company are included at the end of this annual report.

ITEM 19. EXHIBITS

| <u>Exhibit Number</u> | <u>Description of Document</u> |
|-----------------------|---|
| 1.1 | Articles of Incorporation and By-laws, as amended on March 21, 2006 and July 14, 2011 (incorporated by reference to Exhibit 1.1 from our annual report on Form 20-F (file no. 001-32371) filed with the Securities and Exchange Commission on April 12, 2012) |
| 4.1 | Translation of a Lease between Sinovac Beijing and SinoBioway related to a building of approximately 28,000 square feet, dated August 12, 2004 (incorporated by reference to Exhibit 4.1 from our annual report on Form 20-F (file no. 001-32371) filed with the Securities and Exchange Commission on July 14, 2006) |
| 4.2 | Translation of a Lease between Sinovac Beijing and SinoBioway related to a building of approximately 13,300 square feet, dated August 12, 2004 (incorporated by reference to Exhibit 4.2 from our annual report on Form 20-F (file no. 001-32371) filed with the Securities and Exchange Commission on July 14, 2006) |
| 4.3 | Translation of a Supplement Agreement to the Leases between Sinovac Beijing and SinoBioway (incorporated by reference to Exhibit 4.3 from our annual report on Form 20-F (file no. 001-32371) filed with the Securities and Exchange Commission on July 14, 2006) |
| 4.4 | Stock Option Plan adopted on November 1, 2003 (incorporated by reference to Exhibit 4.4 from our annual report on Form 20-F (file no. 001-32371) filed with the Securities and Exchange Commission on July 14, 2006) |
| 4.5* | Form of Employment Agreement between the Registrant and Officers |
| 4.6 | Translation of Form of Employment Agreement between the Registrant or its subsidiary and any other senior executive officers of the Registrant or its subsidiary (incorporated by reference to Exhibit 4.6 from our annual report on Form 20-F (file no. 001-32371) filed with the Securities and Exchange Commission on July 14, 2006) |
| 4.7 | Form of Non-disclosure, Non-competition and Proprietary Information Agreement between the Registrant or its subsidiary and any other senior executive officers of the Registrant or its subsidiary (incorporated by reference to Exhibit 4.7 from our annual report on Form 20-F (file no. 001-32371) filed with the Securities and Exchange Commission on July 14, 2006) |
| 4.8 | Translation of a Lease between Sinovac Beijing and SinoBioway related to buildings of approximately 37,000 square feet, dated June 4, 2007 (incorporated by reference to Exhibit 4.8 from our annual report on Form 20-F (file no. 001-32371) filed with the Securities and Exchange Commission on March 31, 2008) |
| 4.9 | Share Purchase Agreement between Sinovac Biotech Ltd. and Sansar Capital Management LLC dated January 22, 2008 (incorporated by reference to Exhibit 4.9 from our annual report on Form 20-F (file no. 001-32371) filed with the Securities and Exchange Commission on March 31, 2008) |
| 4.10 | Exclusive Promotion Service Agreement between Sinovac Beijing and GlaxoSmithKline (China) Investment Co., Ltd., dated July 30, 2007 (incorporated by reference to Exhibit 4.10 from our annual report on Form 20-F (file no. 001-32371) filed with the Securities and Exchange Commission on March 31, 2008) |
| 4.11 | Equity Joint Venture Contract dated November 22, 2009 between Sinovac Hong Kong and Dalian Jin Gang (English Translation) (incorporated by reference to Exhibit 99.1 from our current report on Form 6-K (file no. 001-32371) filed with the Securities and Exchange Commission on January 20, 2010) |
| 4.12 | Memorandum of Understanding dated November 22, 2009 between Sinovac Hong Kong and Dalian Jin Gang (English Translation) (incorporated by reference to Exhibit 99.2 from our current report on Form 6-K (file no. 001-32371) filed with the Securities and Exchange Commission on January 20, 2010) |
| 4.13 | Equity Interest Transfer Agreement dated December 17, 2009 between Sinovac Hong Kong and Dalian Jin Gang (English Translation) (incorporated by reference to Exhibit 99.3 from our current report on Form 6-K (file no. 001-32371) filed with the Securities and Exchange Commission on January 20, 2010) |
| 4.14 | Asset Acquisition Agreement dated February 10, 2010 between Sinovac Beijing and Beijing Xingchang High-tech Development Co., Ltd. (English Translation) (incorporated by reference to Exhibit 4.14 from our annual report on Form 20-F (file no. 001-32371) filed with the Securities and Exchange Commission on April 16, 2010) |

| | |
|------------------------|---|
| 4.15 | 2012 Share Incentive Plan adopted on August 22, 2012 (incorporated by reference to Exhibit 4.15 from our annual report on Form 20-F (file no. 001-32371) filed with the Securities and Exchange Commission on April 30, 2013) |
| 4.16 | Translation of a Supplemental Agreement, dated April 8, 2013, to a Lease Contract between Sinovac Beijing and SinoBioway, dated August 12, 2004 (incorporated by reference to Exhibit 4.16 from our annual report on Form 20-F (file no. 001-32371) filed with the Securities and Exchange Commission on April 30, 2013) |
| 4.17 | Translation of a Supplemental Agreement, dated April 8, 2013, to a Lease Contract between Sinovac Beijing and SinoBioway, dated June 4, 2007 (incorporated by reference to Exhibit 4.17 from our annual report on Form 20-F (file no. 001-32371) filed with the Securities and Exchange Commission on April 30, 2013) |
| 4.18 | Translation of a Supplemental Agreement, dated August 12, 2010, to a Lease Contract between Sinovac Beijing and SinoBioway, dated August 12, 2004 (incorporated by reference to Exhibit 4.18 from our annual report on Form 20-F (file no. 001-32371) filed with the Securities and Exchange Commission on April 30, 2013) |
| 4.19 | Translation of a Supplemental Agreement, dated April 8, 2013, to a Lease Contract between Sinovac Beijing and SinoBioway, dated August 12, 2004, and the Supplemental Agreement between Sinovac Beijing, Sinovac R&D and SinoBioway, dated August 12, 2010 (incorporated by reference to Exhibit 4.19 from our annual report on Form 20-F (file no. 001-32371) filed with the Securities and Exchange Commission on April 30, 2013) |
| 4.20 | Rights Agreement, dated as of March 28, 2016, between Sinovac Biotech Ltd. and Pacific Stock Transfer Company, as Rights Agent (incorporated by reference to Exhibit 4.1 from our current report on Form 6-K (file no. 001-32371) filed with the Securities and Exchange Commission on March 29, 2016) |
| 4.21 | Amendment to Rights Agreement, dated as of March 24, 2017, between Sinovac Biotech Ltd. and Pacific Stock Transfer Company, as Rights Agent (incorporated by reference to Exhibit 4.1 from our current report on Form 6-K (file no. 001-32371) filed with the Securities and Exchange Commission on March 24, 2017) |
| 4.22 | Second Amendment to Rights Agreement, dated as of June 26, 2017, between Sinovac Biotech Ltd. and Pacific Stock Transfer Company, as Rights Agent (incorporated by reference to Exhibit 4.1 from our current report on Form 6-K (file no. 001-32371) filed with the Securities and Exchange Commission on June 30, 2017) |
| 4.23 | Third Amendment to Rights Agreement, dated as of March 6, 2018, between Sinovac Biotech Ltd. and Pacific Stock Transfer Company, as Rights Agent (incorporated by reference to Exhibit 4.1 from our current report on Form 6-K (file no. 001-32371) filed with the Securities and Exchange Commission on March 6, 2018) |
| 8.1* | List of Subsidiaries |
| 11.1 | Code of Business Conduct and Ethics (incorporated by reference to Exhibit 11.1 from our annual report on Form 20-F (file no. 001-32371) filed with the Securities and Exchange Commission on July 14, 2006) |
| 12.1* | CEO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 12.2* | CFO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 13.1** | CEO Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 13.2** | CFO Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 15.1* | Consent of Ernst & Young Hua Ming LLP |
| 101.INS* | XBRL Instance Document |
| 101.SCH* | XBRL Taxonomy Extension Scheme Document |
| 101.CAL* | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF* | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB* | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE* | XBRL Taxonomy Extension Presentation Linkbase Document |

* Filed with this annual report on Form 20-F

** Furnished with this annual report on Form 20-F

SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

Sinovac Biotech Ltd.

By: /s/ Weidong Yin

Name: Weidong Yin

Title: Chairman and Chief Executive Officer

Date: May 11, 2018

SINOVAC BIOTECH LTD.

CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of U.S. dollars, unless otherwise stated)

December 31, 2017 and 2016

| | |
|--|-----------------------------|
| <u>Index</u> | |
| <u>Reports of Independent Registered Public Accounting Firm – Ernst & Young Hua Ming LLP</u> | <u>F-3</u> |
| <u>Consolidated Balance Sheets</u> | <u>F-5</u> |
| <u>Consolidated Statements of Comprehensive Income (Loss)</u> | <u>F-6</u> |
| <u>Consolidated Statements of Shareholders' Equity</u> | <u>F-7</u> |
| <u>Consolidated Statements of Cash Flows</u> | <u>F-10</u> |
| <u>Notes to Consolidated Financial Statements</u> | <u>F-11</u> |

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and the Board of Directors of Sinovac Biotech Ltd.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Sinovac Biotech Ltd. (the “Company”) as of December 31, 2017 and 2016, the related consolidated statements of comprehensive income (loss), shareholders' equity and cash flows for each of the three years in the period ended December 31, 2017, and the related notes (collectively referred to as the “financial statements”). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2017, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company's internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated May 11, 2018 expressed an unqualified opinion thereon.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Ernst & Young Hua Ming LLP

We have served as the Company's auditor since 2013.
Beijing, the People's Republic of China
May 11, 2018

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and the Board of Directors of Sinovac Biotech Ltd.

Opinion on Internal Control over Financial Reporting

We have audited Sinovac Biotech Ltd.'s internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the "COSO criteria"). In our opinion, Sinovac Biotech Ltd. (the "Company") maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated balance sheets of the Company as of December 31, 2017 and 2016, the related consolidated statements of comprehensive income (loss), shareholders' equity and cash flows for each of the three years in the period ended December 31, 2017, and the related notes and our report dated May 11, 2018 expressed an unqualified opinion thereon.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Ernst & Young Hua Ming LLP

Beijing, the People's Republic of China
May 11, 2018

SINOVAC BIOTECH LTD.

Consolidated Balance Sheets

As of December 31, 2017 and 2016

(Expressed in thousands of U.S. dollars, except for number of shares and per share data)

| | December 31, 2017 | December 31, 2016 |
|---|------------------------------|------------------------------|
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 114,415 | \$ 62,434 |
| Restricted cash (note 4) | 1,549 | 3,007 |
| Accounts receivable – net (notes 5) | 66,205 | 49,832 |
| Inventories (note 6) | 19,618 | 14,102 |
| Prepaid expenses and deposits (including prepaid expenses to related party of 2017 - \$366, 2016 - \$343) (note 11 (b)) | 2,101 | 1,372 |
| Total current assets | 203,888 | 130,747 |
| Property, plant and equipment (notes 8) | 76,430 | 66,882 |
| Prepaid land lease payments (notes 9) | 9,028 | 8,697 |
| Long-term inventories (note 7) | - | 98 |
| Long-term prepaid expenses (including prepaid expenses to related party of 2017 - \$25, 2016 - \$23) (note 11(b)) | 25 | 23 |
| Prepayments for acquisition of equipment | 528 | 964 |
| Deferred tax assets (note 13) | 9,320 | 3,944 |
| Total assets | \$ 299,219 | \$ 211,355 |
| LIABILITIES AND EQUITY | | |
| Current liabilities | | |
| Short-term bank loans (note 10) | \$ 18,152 | \$ 31,279 |
| Loan from a non-controlling shareholder (note 11 (a)) | - | 2,304 |
| Accounts payable and accrued liabilities (note 12) | 59,418 | 24,960 |
| Income tax payable | 8,862 | 3,178 |
| Deferred revenue (note 14) | 4,073 | 2,766 |
| Deferred government grants (note 15) | 2,038 | 1,777 |
| Total current liabilities | 92,543 | 66,264 |
| Deferred government grants (note 15) | 4,474 | 2,953 |
| Long-term bank loans (note 10) | 14,849 | 9,448 |
| Deferred revenue (note 14) | - | 89 |
| Loan from a non-controlling shareholder (note 11 (a)) | 7,070 | - |
| Other non-current liabilities (note 13) | 3,143 | 2,935 |
| Total long-term liabilities | 29,536 | 15,425 |
| Total liabilities | 122,079 | 81,689 |
| Commitments and contingencies (notes 16 and 23) | | |
| EQUITY | | |
| Preferred stock | - | - |
| Authorized 50,000,000 shares at par value of \$0.001 each | | |
| Issued and outstanding: nil | | |
| Common stock (note 17) | 57 | 57 |
| Authorized: 100,000,000 shares at par value of \$0.001 each | | |
| Issued and outstanding: 57,281,861 (2016 – 57,011,761) | | |
| Additional paid-in capital | 115,339 | 112,668 |
| Accumulated other comprehensive income | 7,075 | 168 |
| Statutory surplus reserves (note 19) | 19,549 | 14,788 |
| Accumulated earnings (deficit) | 9,132 | (11,914) |
| Total shareholders' equity | 151,152 | 115,767 |
| Non-controlling interests (note 20) | 25,988 | 13,899 |
| Total equity | 177,140 | 129,666 |
| Total liabilities and equity | \$ 299,219 | \$ 211,355 |

The accompanying notes are an integral part of these consolidated financial statements.

SINOVAC BIOTECH LTD.

Consolidated Statements of Comprehensive Income (Loss)

For the years ended December 31, 2017, 2016 and 2015

(Expressed in thousands of U.S. Dollars, except for number of shares and per share data)

| | For the year ended December 31 | | |
|---|--------------------------------|-----------------|-------------------|
| | 2017 | 2016 | 2015 |
| Sales (note 22) | \$ 174,346 | \$ 72,431 | \$ 67,414 |
| Cost of sales | <u>20,240</u> | <u>22,393</u> | <u>18,408</u> |
| Gross profit | <u>154,106</u> | <u>50,038</u> | <u>49,006</u> |
| Selling, general and administrative expenses (including rent expenses incurred to related party of 2017 - \$793, 2016 - \$807, 2015 - \$852) (note 11(b)) | 87,365 | 41,980 | 37,481 |
| Provision (recovery) for doubtful accounts | 934 | 1,412 | (49) |
| Research and development expenses | 20,489 | 12,648 | 9,490 |
| Loss on disposal of property, plant and equipment (note 8) | 42 | 478 | 26 |
| Government grants recognized in income | <u>(141)</u> | <u>(6,984)</u> | <u>(1,637)</u> |
| Total operating expenses | <u>108,689</u> | <u>49,534</u> | <u>45,311</u> |
| Operating income | <u>45,417</u> | <u>504</u> | <u>3,695</u> |
| Interest and financing expenses – (including interest expenses incurred to related party, 2017 - \$262, 2016 - \$176, 2015 - \$183) (note 11(a)) | (1,569) | (1,729) | (1,920) |
| Interest income | 1,183 | 731 | 1,155 |
| Other income (expenses), net | <u>13</u> | <u>100</u> | <u>(174)</u> |
| Income (loss) from continuing operations before income taxes | <u>45,044</u> | <u>(394)</u> | <u>2,756</u> |
| Income tax expense (note 13) | <u>(8,339)</u> | <u>(2,664)</u> | <u>(2,985)</u> |
| Income (loss) from continuing operations | <u>36,705</u> | <u>(3,058)</u> | <u>(229)</u> |
| Income (loss) from discontinued operations, net of tax of nil (note 3) | <u>-</u> | <u>2,338</u> | <u>(728)</u> |
| Net income (loss) | <u>36,705</u> | <u>(720)</u> | <u>(957)</u> |
| Less: (Income) loss attributable to non-controlling interests | <u>(10,898)</u> | <u>124</u> | <u>(459)</u> |
| Net income (loss) attributable to shareholders of Sinovac | <u>\$ 25,807</u> | <u>\$ (596)</u> | <u>\$ (1,416)</u> |
| Income (loss) from continuing operations | <u>36,705</u> | <u>(3,058)</u> | <u>(229)</u> |
| Other comprehensive loss from continuing operations, net of tax of nil | | | |
| Foreign currency translation adjustments | 8,098 | (8,843) | (4,047) |
| Comprehensive income (loss) from continuing operations | <u>44,803</u> | <u>(11,901)</u> | <u>(4,276)</u> |
| Income (loss) from discontinued operations | <u>-</u> | <u>2,338</u> | <u>(728)</u> |
| Other comprehensive loss from discontinued operations, net of tax of nil | | | |
| Foreign currency translation adjustments | - | - | (338) |
| Comprehensive income (loss) from discontinued operations | <u>\$ -</u> | <u>\$ 2,338</u> | <u>\$ (1,066)</u> |
| Comprehensive income (loss) | <u>44,803</u> | <u>(9,563)</u> | <u>(5,342)</u> |
| Less: comprehensive (income) loss attributable to non-controlling interests | <u>(12,089)</u> | <u>953</u> | <u>82</u> |
| Comprehensive income (loss) attributable to shareholders of Sinovac | <u>32,714</u> | <u>(8,610)</u> | <u>(5,260)</u> |
| Earnings (loss) per share (note 21) | | | |
| Basic net income (loss) per share: | | | |
| Continuing operations | 0.45 | (0.05) | (0.02) |
| Discontinued operations | - | 0.04 | (0.01) |
| Basic net income (loss) per share | <u>0.45</u> | <u>(0.01)</u> | <u>(0.03)</u> |
| Diluted net income (loss) per share: | | | |
| Continuing operations | 0.45 | (0.05) | (0.02) |
| Discontinued operations | - | 0.04 | (0.01) |
| Diluted net income (loss) per share | <u>0.45</u> | <u>(0.01)</u> | <u>(0.03)</u> |

Weighted average number of shares of common stock outstanding

| | | | |
|-----------|------------|------------|------------|
| - Basic | 57,033,816 | 56,949,083 | 56,313,927 |
| - Diluted | 57,101,191 | 56,949,083 | 56,313,927 |

The accompanying notes are an integral part of these consolidated financial statements.

SINOVAC BIOTECH LTD.

Consolidated Statements of Shareholders' Equity

For the years ended December 31, 2017, 2016 and 2015

(Expressed in thousands of U.S. dollars, except number of shares data)

| | Common stock | | Additional paid-in capital | Accumulated other comprehensive income (foreign currency translation adjustment) | Statutory surplus reserves | Accumulated deficit | Total shareholders' equity | Non- controlling interests | Total equity |
|--|-------------------|-----------|----------------------------------|--|----------------------------------|------------------------|----------------------------------|----------------------------------|-----------------|
| | Shares | Amount | | | | | | | |
| Balance, December 31, 2014 | 55,809,661 | \$ 56 | \$ 108,243 | \$ 12,026 | \$ 12,627 | \$ (7,741) | \$ 125,211 | \$ 14,934 | \$ 140,145 |
| Share-based compensation (note 18) | - | - | 952 | - | - | - | 952 | - | 952 |
| Exercise of stock options (note 17) | 367,900 | - | 732 | - | - | - | 732 | - | 732 |
| Subscriptions received (note 17) | - | - | 18 | - | - | - | 18 | - | 18 |
| 2015 restricted shares issued (note 17) | 729,000 | 1 | (1) | - | - | - | - | - | - |
| Other comprehensive loss | | | | | | | | | |
| - Other comprehensive loss attributable to non-controlling interests | - | - | - | - | - | - | - | (541) | (541) |
| - Other comprehensive loss attributable to shareholders | - | - | - | (3,844) | - | - | (3,844) | - | (3,844) |
| Net loss for the year | | | | | | | | | |
| -Net income attributable to non-controlling interests | - | - | - | - | - | - | - | 459 | 459 |
| - Net loss attributable to shareholders of Sinovac | - | - | - | - | - | (1,416) | (1,416) | - | (1,416) |
| - Transfer to statutory surplus reserves (note 19) | - | - | - | - | 823 | (823) | - | - | - |
| Balance, December 31, 2015 | <u>56,906,561</u> | <u>57</u> | <u>109,944</u> | <u>8,182</u> | <u>13,450</u> | <u>(9,980)</u> | <u>121,653</u> | <u>14,852</u> | <u>136,505</u> |

The accompanying notes are an integral part of these consolidated financial statements

SINOVAC BIOTECH LTD.

Consolidated Statements of Shareholders' Equity

For the years ended December 31, 2017, 2016 and 2015

(Expressed in thousands of U.S. dollars, except number of shares data)

| | Common stock | | Additional paid-in capital | Accumulated other comprehensive income (foreign currency translation adjustment) | Statutory surplus reserves | Accumulated deficit | Total shareholders' equity | Non- controlling interests | Total equity |
|--|-------------------|--------------|----------------------------------|--|----------------------------------|------------------------|----------------------------------|----------------------------------|-------------------|
| | Shares | Amount | | | | | | | |
| Balance, December 31, 2015 | 56,906,561 | \$ 57 | \$ 109,944 | \$ 8,182 | \$ 13,450 | \$ (9,980) | \$ 121,653 | \$ 14,852 | \$ 136,505 |
| Share-based compensation (note 18) | - | - | 2,409 | - | - | - | 2,409 | - | 2,409 |
| Exercise of stock options (note 17) | 120,000 | - | 315 | - | - | - | 315 | - | 315 |
| Cancellation of outstanding shares (note 17) | (14,800) | - | - | - | - | - | - | - | - |
| Other comprehensive loss | | | | | | | | | |
| - Other comprehensive loss attributable to non-controlling interests | - | - | - | - | - | - | - | (829) | (829) |
| - Other comprehensive loss attributable to shareholders | - | - | - | (8,014) | - | - | (8,014) | - | (8,014) |
| Net loss for the year | | | | | | | | | |
| -Net loss attributable to non-controlling interests | - | - | - | - | - | - | - | (124) | (124) |
| - Net loss attributable to shareholders of Sinovac | - | - | - | - | - | (596) | (596) | - | (596) |
| - Transfer to statutory surplus reserves (note 19) | - | - | - | - | 1,338 | (1,338) | - | - | - |
| Balance, December 31, 2016 | <u>57,011,761</u> | <u>\$ 57</u> | <u>\$ 112,668</u> | <u>\$ 168</u> | <u>\$ 14,788</u> | <u>\$ (11,914)</u> | <u>\$ 115,767</u> | <u>\$ 13,899</u> | <u>\$ 129,666</u> |

The accompanying notes are an integral part of these consolidated financial statements

SINOVAC BIOTECH LTD.

Consolidated Statements of Shareholders' Equity

For the years ended December 31, 2017, 2016 and 2015

(Expressed in thousands of U.S. dollars, except for number of shares data)

| | Common stock | | Additional paid-in capital | Accumulated other comprehensive income (foreign currency translation adjustment) | Statutory surplus reserves | Accumulated (deficit) earnings | Total shareholders' equity | Non- controlling interests | Total equity |
|--|-------------------|--------------|----------------------------------|---|----------------------------------|-----------------------------------|----------------------------------|----------------------------------|-------------------|
| | Shares | Amount | | | | | | | |
| Balance, December 31, 2016 | 57,011,761 | \$ 57 | \$ 112,668 | \$ 168 | \$ 14,788 | \$ (11,914) | \$ 115,767 | \$ 13,899 | \$ 129,666 |
| Share-based compensation (note 18) | - | - | 979 | - | - | - | 979 | - | 979 |
| Exercise of stock options (note 17) | 270,100 | - | 1,264 | - | - | - | 1,264 | - | 1,264 |
| Subscriptions received (note 17) | - | - | 428 | - | - | - | 428 | - | 428 |
| Other comprehensive income | | | | | | | | | |
| - Other comprehensive income attributable to non-controlling interests | - | - | - | - | - | - | - | 1,191 | 1,191 |
| - Other comprehensive income attributable to shareholders | - | - | - | 6,907 | - | - | 6,907 | - | 6,907 |
| Net income for the year | | | | | | | | | |
| -Net income attributable to non-controlling interests | - | - | - | - | - | - | - | 10,898 | 10,898 |
| - Net income attributable to shareholders of Sinovac | - | - | - | - | - | 25,807 | 25,807 | - | 25,807 |
| - Transfer to statutory surplus reserves (note 19) | - | - | - | - | 4,761 | (4,761) | | | |
| Balance, December 31, 2017 | <u>57,281,861</u> | <u>\$ 57</u> | <u>\$ 115,339</u> | <u>\$ 7,075</u> | <u>\$ 19,549</u> | <u>\$ 9,132</u> | <u>\$ 151,152</u> | <u>\$ 25,988</u> | <u>\$ 177,140</u> |

The accompanying notes are an integral part of these consolidated financial statements.

SINOVAC BIOTECH LTD.

Consolidated Statements of Cash Flows

For the years ended December 31, 2017, 2016 and 2015

(Expressed in thousands of U.S. dollars)

| | For the year ended December 31 | | |
|--|---------------------------------------|------------------|------------------|
| | 2017 | 2016 | 2015 |
| Cash flows provided by (used in) operating activities | | | |
| Income (loss) from continuing operations | \$ 36,705 | \$ (3,058) | \$ (229) |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | | |
| - Deferred income taxes (note 13) | (4,921) | (1,007) | (333) |
| - Share-based compensation (note 18) | 979 | 2,409 | 952 |
| - Inventory provision (note 6) | 1,231 | 6,377 | 1,820 |
| - Provision (recovery) for doubtful accounts | 934 | 1,412 | (49) |
| - Loss on disposal of property, plant and equipment (note 8) | 42 | 478 | 26 |
| - Depreciation of property, plant and equipment and amortization of licenses (note 8) | 4,638 | 5,063 | 6,258 |
| - Amortization of prepaid land lease payments (note 9) | 243 | 247 | 261 |
| - Government grants recognized in income | (141) | (6,984) | (1,637) |
| - Accretion expenses | - | - | 120 |
| Changes in: | | | |
| - Accounts receivable | (13,482) | (15,122) | 41 |
| - Inventories | (5,531) | (3,025) | 28 |
| - Income tax payable | 4,948 | 1,720 | 576 |
| - Prepaid expenses and deposits | (622) | (436) | 434 |
| - Deferred revenue | 987 | (4,959) | (3,639) |
| - Accounts payable and accrued liabilities | 33,416 | 2,739 | (298) |
| - Other non-current liabilities | 330 | 339 | 779 |
| - Restricted cash | 1,598 | (1,557) | (1,677) |
| - Time deposits | - | - | 1,500 |
| Net cash provided by (used in) operating activities from continuing operations | 61,354 | (15,364) | 4,933 |
| Net cash used in operating activities from discontinued operations | - | (95) | (722) |
| Net cash provided by (used in) operating activities | 61,354 | (15,459) | 4,211 |
| Cash flows provided by (used in) financing activities | | | |
| - Proceeds from bank loans | 28,636 | 45,462 | 21,312 |
| - Repayments of bank loans | (38,708) | (24,850) | (46,786) |
| - Proceeds from issuance of common stock, net of share issuance costs | 1,264 | 315 | 732 |
| - Proceeds from shares subscribed | 428 | - | 18 |
| - Government grants received (note 15) | 2,598 | 6,857 | 544 |
| - Loan from a non-controlling shareholder (note 11(a)) | 4,440 | - | - |
| - Repayment of loan from a non-controlling shareholder | - | - | (16) |
| Net cash provided by (used in) financing activities | (1,342) | 27,784 | (24,196) |
| Cash flows used in investing activities | | | |
| - Proceeds from disposal of equipment | 19 | 26 | 81 |
| - Acquisition of property, plant and equipment | (11,915) | (12,654) | (5,299) |
| - Net proceeds from disposal of subsidiary | - | 861 | 801 |
| Net cash used in investing activities from continuing operations | (11,896) | (11,767) | (4,417) |
| Net cash used in investing activities from discontinued operations | - | (9) | (98) |
| Net cash used in investing activities | (11,896) | (11,776) | (4,515) |
| Effect of exchange rate changes on cash and cash equivalents, including cash classified within current assets held for sale | 3,865 | (2,092) | (1,541) |
| Increase (decrease) in cash and cash equivalents, including cash from discontinued operation | 51,981 | (1,543) | (26,041) |
| Less: Net decrease in cash from discontinued operation | - | (143) | (82) |
| Increase (decrease) in cash and cash equivalents | 51,981 | (1,400) | (25,959) |
| Cash and cash equivalents, beginning of year | 62,434 | 63,834 | 89,793 |
| Cash and cash equivalents, end of year | \$ 114,415 | \$ 62,434 | \$ 63,834 |
| Supplemental disclosure of cash flow information: | | | |
| Cash paid for interest | \$ 1,325 | \$ 1,662 | \$ 1,722 |
| Cash paid for income taxes | \$ 7,909 | \$ 1,885 | \$ 2,058 |

The accompanying notes are an integral part of these consolidated financial statements

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)**1. Basis of Presentation**

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“US GAAP”). They include the accounts of Sinovac Biotech Ltd., which is incorporated under the laws of Antigua and Barbuda, and its wholly owned or controlled subsidiaries (collectively, the “Company”). All significant intercompany transactions have been eliminated. Details of the Company’s subsidiaries are as follows:

| Name | Date of incorporation or establishment | Place of incorporation (or establishment) /operation | Percentage of ownership as of December 31, 2017 | Percentage of ownership as of December 31, 2016 | Principal activities |
|--|---|---|--|--|--|
| Sinovac Biotech (Hong Kong) Ltd. (“Sinovac Hong Kong”) | October 2008 | Hong Kong | 100% | 100% | Investment holding company |
| Sinovac Biotech Co., Ltd. (“Sinovac Beijing”) (note 20) | April 2001 | People’s Republic of China (“PRC”) | 73.09% | 73.09% | Research and development, production and sales of vaccine products |
| Sinovac Research & Development Co., Ltd. (“Sinovac R&D”) | May 2009 | PRC | 100% | 100% | Research and development of vaccine products |
| Sinovac (Dalian) Vaccine Technology Co., Ltd. (“Sinovac Dalian”) (note 20) | January 2010 | PRC | 67.86% | 67.86% | Research and development, production and sales of vaccine products |
| Sinovac Biomed Co., Ltd. | April 2015 | PRC | 100% | 100% | Distribution of vaccine products |

2. Significant Accounting Policies**(a) Use of Estimates**

In preparation of the Company’s consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting periods. Significant estimates made by management include: provision for product returns, allowance for doubtful accounts, inventory provisions, useful lives of amortizable intangible assets, impairment of long-lived assets, fair value of options granted and related forfeiture rates, and realizability of deferred tax assets. On an ongoing basis, management reviews its estimates to ensure that these estimates appropriately reflect changes in the Company’s business and new information as it becomes available. If historical experience and other factors used by management to make these estimates do not reasonably reflect future activity, the Company’s consolidated financial statements could be materially impacted.

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

(b) Cash and Cash Equivalents

Cash equivalents consist of highly liquid investments that are readily convertible to cash generally with maturities of three months or less when purchased.

(c) Restricted Cash

Restricted cash is cash held as collateral for transactions and a certain loan the Company has entered into.

(d) Accounts Receivable

The Company extends unsecured credit to its customers in the ordinary course of business and actively pursues past due accounts. The Company estimates an allowance for doubtful accounts based on historical experience, the age of the accounts receivable balances, credit quality of the Company's customers, current economic conditions and other factors that may affect its customers' ability to pay.

(e) Inventories

Inventories are stated at the lower of cost or net realizable value. The cost of work in progress and finished goods is determined on a weighted-average cost basis and includes direct material, direct labor and overhead costs. Net realizable value represents the anticipated selling price, net of distribution cost, less estimated costs to completion for work in progress.

(f) Property, Plant and Equipment

Property, plant and equipment are recorded at cost. Significant additions and improvements are capitalized, while repairs and maintenance are charged to expenses as incurred. Equipment purchased for specific research and development projects with no alternative uses are expensed. Assets under construction are not depreciated until construction is completed and the assets are ready for their intended use. Gains and losses from the disposal of property, plant and equipment are recorded in gain or loss on disposal and impairment of property, plant and equipment included in the consolidated statements of comprehensive income (loss).

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

Depreciation of property, plant and equipment is computed using the straight-line method based on the estimated useful lives of the assets as follows:

| | |
|--------------------------------|--|
| Plant and buildings | 10 to 24 years |
| Machinery and equipment | 8 to 10 years |
| Motor vehicles | 4 to 5 years |
| Office equipment and furniture | 3 to 5 years |
| Leasehold improvements | Lesser of useful lives and term of lease |

(g) Prepaid Land Lease Payments

Prepaid land lease payments represent amounts paid for the rights to use land in the PRC and is recorded at purchased cost less accumulated amortization. Amortization is provided on a straight-line basis over the term of the lease agreement, which ranges from 28 to 49 years.

(h) Licenses

The Company capitalizes the patent payment and the purchased cost of vaccines if the vaccine has received a new drug certificate from the China Food and Drug Administration (“CFDA”) of China. If the vaccine has not received a new drug certificate, the purchase cost is expensed as in-process research and development.

Licenses in relation to the production and sales of pharmaceutical products are amortized on a straight-line basis over their respective useful lives. Costs incurred to renew or extend the term of licenses are capitalized and amortized over the license’s useful life on a straight-line basis.

(i) Impairment of Long-Lived Assets

Long-lived assets including intangible assets subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of an asset group may not be recoverable from the future undiscounted net cash flows expected to be generated by the asset group. An asset group is identified as assets at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets. If the asset group is not fully recoverable, an impairment loss would be recognized for the difference between the carrying value of the asset group and its estimated fair value, based on the discounted net future cash flows or other appropriate methods, such as comparable market values. The Company uses estimates and judgments in its impairment tests and if different estimates or judgment had been utilized, the timing or the amount of any impairment charges could be materially different.

(j) Income Taxes

The Company follows the liability method of accounting for income taxes. Under this method, deferred tax liabilities and assets are determined based on the temporary differences between the carrying values and tax bases of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse. A valuation allowance is provided if, based on the weight of available evidence, it is more-likely-than-not that some portion, or all, of the deferred tax assets will not be realized. Deferred tax assets and liabilities are measured using enacted tax rates and laws. In November 2015, the FASB issued ASU No. 2015-17 (“ASU 2015-17”), Balance Sheet Classification of Deferred Taxes, simplifying the presentation of deferred income taxes, where deferred tax liabilities and assets are to be classified as non-current in a classified statement of financial position. The Company adopted this standard on January 1, 2017 using the retrospective method. As a result deferred tax assets of \$3,492 that were presented in the Company’s December 31, 2016 consolidated balance sheet have been reclassified to non-current deferred tax assets.

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

The tax benefit from an uncertain tax position is recognized only if it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority, based on the technical merits of the position. The tax benefits recognized from such a position are measured based on the amount that is greater than 50% likely of being realized upon settlement. The Company recognizes a change in available facts after the reporting date but before issuance of the financial statements in the period when the change in facts occur, even if that new information provides a better estimate of the ultimate outcome of an uncertainty. Liabilities associated with uncertain tax positions are classified as long-term unless expected to be paid within one year. Interest and penalties related to uncertain tax positions, if any, are recorded in the provision for income taxes and classified with the related liability on the consolidated balance sheets.

(k) Value-added Taxes

Value-added taxes (“VAT”) collected from customers relating to product sales and remitted to governmental authorities are presented on a net basis. VAT collected from customers is excluded from revenue.

(l) Revenue Recognition

Revenue is recognized when persuasive evidence of an arrangement exists, the price is fixed and determinable, delivery has occurred and there is a reasonable assurance of collection of the sales proceeds. The Company generally obtains purchase authorizations from its customers for a specified amount of products at a specified price and considers delivery to have occurred when the customer takes title of the products. The Company provides certain customers with a right of return.

Revenue for inactivated hepatitis A, combined inactivated hepatitis A&B, seasonal influenza and enterovirus 71 vaccines are recognized when delivery has occurred and the Company can reasonably estimates return provision for these products. The product return provisions for inactivated hepatitis A vaccine and combined inactivated hepatitis A&B vaccine are estimated based on historical return and exchange data as well as the inventory levels and the remaining shelf lives of the products in the distribution channels. The Company started selling enterovirus 71 vaccines in 2016. For the year ended December 31, 2016, product return provision for enterovirus 71 vaccine was based on historical return and exchange data of similar products including hepatitis A and combined inactivated hepatitis A&B vaccines, as well as enterovirus 71 vaccines’ inventory levels and remaining shelf lives in the distribution channels. The Company reviews the estimated sales return on an ongoing basis. This review indicated that the Company’s marketing and distributing strategy of enterovirus 71 vaccines shifted to a manner similar to inactivated hepatitis A vaccine, and no longer distributes the product in a manner similar to combined inactivated hepatitis A&B vaccine. For the year ended December 31, 2017, product return provision for enterovirus 71 vaccine was based on historical return and exchange data of hepatitis A, as well as enterovirus 71 vaccines’ inventory levels and remaining shelf lives in the distribution channels. The change in estimate resulted in an increase to income from continuing operations and net income attributable to shareholders of Sinovac of \$8,074 and \$5,901, respectively. In addition, basic and diluted earnings per share increased by \$0.10 and \$0.10, respectively.

As of December 31, 2017, sales return provision for inactivated hepatitis A vaccine, combined inactivated hepatitis A&B vaccine and enterovirus 71 vaccine was \$4,672 (December 31, 2016 - \$5,039). Private pay sales return provision of inactivated hepatitis A vaccine, combined inactivated hepatitis A&B vaccine and enterovirus 71 vaccine as a percentage of sales was 3.1% and 10.9% in 2017 and 2016, respectively. The Company does not accept returns for hepatitis products sold under the Expanded Program on Immunization and exports. As such, no sales returns are estimated for these sales. Product return provision for seasonal influenza vaccines is estimated based on actual sales returns and expected sales returns up to the end of the flu season because the Company generally accepts returns before the end of the flu season. As of December 31, 2017, sales return provision for seasonal influenza vaccine returns was approximately \$263 (December 31, 2016 - \$533).

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

Revenue for mumps vaccines without a right of return provided to customers is recognized when delivery has occurred. Revenue for mumps vaccines with a right of return provided to customers is recognized when payments are collected from customers.

Deferred revenue is generally related to government stockpiling programs and advances received from customers. For government stockpiling programs of H5N1 vaccines, the Company generally obtains purchase authorizations from the government for a specified amount of products at a specified price and no rights of return are provided. Revenue is recognized when the government takes delivery of the products. If the products expire prior to delivery, these expired products are recognized as revenue once cash is received and the products have expired and passed government inspection.

(m) Shipping and Handling

Shipping and handling fees billed to customers are included in sales. Costs related to shipping and handling are recognized in selling, general and administrative expenses in the consolidated statements of comprehensive income (loss). For the year ended December 31, 2017, \$5,759 of shipping and handling costs was included in selling, general and administrative expenses (2016 - \$1,654, 2015-\$1,389).

(n) Advertising Expenses

Advertising costs are expensed as incurred and included in selling, general and administrative expenses. Advertising costs were \$4,007 for the year ended December 31, 2017 (2016 - \$3,336, 2015 - \$2,777).

(o) Research and Development

Research and development ("R&D") costs are expensed as incurred and are disclosed as a separate line item in the Company's consolidated statements of comprehensive income (loss). R&D costs consist primarily of the remuneration of R&D staff, depreciation, material, clinical trial costs as well as amortization of acquired technology and know-how used in R&D with alternative future uses. R&D costs also include costs associated with collaborative R&D and in-licensing arrangements, including upfront fees paid to collaboration partners in connection with technologies which have not reached technological feasibility and did not have an alternative future use. Reimbursement of R&D costs for arrangements with collaboration partners is recognized when the obligations are incurred.

Under certain R&D arrangements with third parties, the Company may be required to make payments that are contingent on the achievement of specific development, regulatory and/or commercial milestones. Before a product receives regulatory approval, license fees and milestone payments made to third parties are expensed as incurred. License fees and milestone payments made to third parties after regulatory approval is received are capitalized and amortized over the remaining life of the agreement with third parties.

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)**(p) Government Grants**

Government grants received from the PRC government by the PRC operating subsidiaries of the Company are recognized when there is reasonable assurance that the amount is receivable and all the conditions specified in the grant have been met. Government grants for R&D are recognized as a reduction to R&D expenses when the expenses are incurred in the same period when the conditions attached to the grants are met, or recognized as government grants recognized in income in the period when the conditions are met after the expenses are incurred. Government grants for property, plant and equipment are deferred and recognized as a reduction to the related depreciation and amortization expenses in the same manner as the property, plant and equipment are depreciated. Interest subsidies are recorded as a reduction to interest and financing expenses in the consolidated statements of comprehensive income (loss), or recorded as a reduction to interest capitalized if the subsidies granted are related to a specific borrowing associated with building a qualifying asset. For government loans received at below market interest rate, the difference between the face value of the loan and fair value using the effective interest rate method is recorded as deferred government grants. Accretion expense is recorded in interest and financing expense and the government grant will be recognized as "government grants recognized in income" in the consolidated statement of comprehensive income (loss) when the government loan is fully repaid.

(q) Retirement and Other Post-retirement Benefits

Full-time employees of the Company in the PRC participate in a government mandated defined contribution plan pursuant to which certain pension benefits, medical care, unemployment insurance, employee housing fund and other welfare benefits are provided to employees. Chinese labor regulations require that the Company makes contributions to the government for these benefits based on certain percentages of the employees' salaries. The Company has no legal obligation for the benefits beyond the contributions. Total amounts for such employee benefits, which were expensed as incurred was \$6,197 for the year ended December 31, 2017 (2016 - \$5,473, 2015 - \$5,126).

(r) Foreign Currency Translation and Transactions

The Company maintains their accounting records in their functional currencies, U.S. dollars ("US\$") for the Company and Sinovac Hong Kong and Renminbi Yuan ("RMB") for the PRC subsidiaries. The Company uses the US\$ as its reporting currency.

At the transaction date, each asset, liability, revenue and expense is re-measured into the functional currency by the use of the exchange rate in effect at that date. At each period end, foreign currency monetary assets, and liabilities are re-measured into the functional currency by using the exchange rate in effect at the balance sheet date. The resulting foreign exchange gains and losses are included in selling, general and administrative expenses. The Company recognized foreign exchange gain of \$1,323 for the year ended December 31, 2017 (2016 - \$942, 2015 - \$865).

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

Assets and liabilities of the PRC subsidiaries, Sinovac Beijing, Sinovac R&D, Sinovac Dalian and Sinovac Biomed are translated into US\$ at the exchange rates in effect at the balance sheet date. Revenue and expenses are translated at average exchange rates. Gains and losses from such translations are recorded in accumulated other comprehensive income, a component of shareholders' equity.

Gain on intra-entity foreign currency transactions that are of a long-term-investment nature was \$336 for the year ended December 31, 2017 (2016 - \$335 in losses, 2015 - \$560 in losses) which was recorded in accumulated other comprehensive income, a component of shareholders' equity.

(s) Share-based Compensation

Compensation expense for costs related to all share-based payments, including grants of stock options, is recognized through a fair-value based method. The Company uses the Black-Scholes option-pricing model to determine the grant date fair value for stock options. The Company uses the grant date stock price to determine the grant date fair value of restricted shares. The Company has elected to recognize share-based compensation costs using the straight-line method over the requisite service period with a graded vesting schedule, provided that the amount of compensation costs recognized at any date is at least equal to the portion of the grant date value of the awards that are vested at that date. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from initial estimates. Share based compensation costs are recorded net of estimated forfeitures such that expense is recorded only for those awards that are expected to vest.

(t) Comprehensive Income (loss)

The Company's comprehensive income (loss) consists of net income (loss) and foreign currency translation adjustments.

(u) Earnings (loss) Per Share

Earnings (loss) per share is calculated in accordance with Accounting Standards Codification ("ASC") 260 *Earnings per Share*. Basic earnings (loss) per share is computed by dividing the net income (loss) attributable to shareholders of Sinovac by the weighted average number of common shares outstanding during the year. Diluted earnings per share is computed in accordance with the treasury stock method and based on the weighted average number of common shares and dilutive common share equivalents. Dilutive common share equivalents are excluded from the computation of diluted earnings per share if their effects would be anti-dilutive.

(v) Operating Leases

Leases are classified as capital and operating depending on the terms and conditions of the lease agreement. Leases that transfer substantially all the benefits and risks incidental to ownership of assets are accounted for as if there was an acquisition of an asset and incurrence of an obligation at the inception of the lease. All other leases are accounted for as operating leases where rental payments are expensed as incurred. There are no capital leases for the periods presented.

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)**(w) Fair Value Measurements**

Assets and liabilities subject to fair value measurements are required to be disclosed within a specified fair value hierarchy. The fair value hierarchy ranks the quality and reliability of inputs, or assumptions, used in the determination of fair value and requires assets and liabilities carried at fair value to be classified and disclosed in one of the following categories based on the lowest level input used that is significant to a particular fair value measurement:

- Level 1 — Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 — Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, or quoted prices for identical or similar assets and liabilities in markets that are not active.
- Level 3 — Unobservable inputs for the asset or liability.

As of December 31, 2017 and 2016, the Company did not have any financial assets or liabilities measured at fair value on a recurring basis.

The carrying values of cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities and short-term bank loans and the current portion of long-term debt approximate their fair value because of their short-term nature. The fair values of long-term bank loans and other debt are estimated based on the discounted value of future contractual cash flows which approximates their carrying value due to the fact they are predominately stated at variable rates based on the People's Bank of China. Fair value of the long-term bank loans and other debt are determined based on level 2 inputs.

The Company measures property, plant and equipment at fair value on a non-recurring basis only if an impairment charge were to be recognized. There were no non-recurring fair value measurements for the years ended December 31, 2017 and 2016.

(x) Concentration of Risks***Exchange Rate Risks***

The Company operates in China, which may give rise to significant foreign currency risks from fluctuations and the degree of volatility of foreign exchange rates between the US\$ and the RMB. In 2017, foreign exchange gain of \$1,323 is included in selling, general and administrative expenses (2016 - \$942, 2015 - \$865). As of December 31, 2017, cash and cash equivalents of \$103,370 (RMB 673 million) is denominated in RMB and are held in PRC and Hong Kong (December 31, 2016 - \$47,234 (RMB 328 million)).

Currency Convertibility Risks

Substantially all of the Company's operating activities are transacted in RMB, which is not freely convertible into foreign currencies. All foreign exchange transactions take place either through the People's Bank of China or other banks authorized to buy and sell foreign currencies at the exchange rates quoted by the People's Bank of China. Approval of foreign currency payments by the People's Bank of China or other regulatory institutions requires submitting a payment application form together with other information such as suppliers' invoices, shipping documents and signed contracts.

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)***Concentration of Credit Risks***

Financial instruments that potentially subject the Company to concentration of credit risks consist primarily of cash and cash equivalents, restricted cash and accounts receivable, the balances of which are stated on the consolidated balance sheets which represent the Company's maximum exposure. The Company places its cash and cash equivalents and restricted cash in good credit quality financial institutions in Hong Kong and China. Concentration of credit risks with respect to accounts receivables is linked to the concentration of revenue. The Company's customers are mainly various government agencies in China. For the year ended December 31, 2017 and 2016, no single customer of the Company accounted for more than 10% of total sales, and one of the Company's customers accounted for 14% of the Company's total revenue for the year ended December 31, 2015. To manage credit risk, the Company performs ongoing credit evaluations of customers' financial condition.

Interest Rate Risks

The Company is subject to interest rate risk. Other than loans from a non-controlling shareholder of \$7,070 with fixed interest rates as of December 31, 2017 (note 11(a)), interests of other interest-bearing loans are charged at variable rates based on the People's Bank of China (note 10).

(y) Recently Issued Accounting Standards

In May 2014, the FASB issued ASU No. 2014-09 ("ASU 2014-09"), Revenue from Contracts with Customers (Topic 606), where a single, global revenue recognition model applies to most contracts with customers. Revenue will be recognized in a manner that depicts the transfer of goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled, subject to certain limitations. In August 2015, the FASB issued ASU 2015-14, where the effective date of ASU 2014-09 was extended to annual periods beginning after December 15, 2017. Early adoption is permitted. Subsequent to the issuance of ASU 2014-09, the FASB has issued several accounting standard updates such as ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net), ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, and ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients among others. These ASUs do not change the core principle of the guidance stated in ASU 2014-09, instead these amendments are intended to clarify and improve operability of certain topics included within the revenue standard. These ASUs will have the same effective date and transition requirements as ASU 2014-09. The Company will adopt the new standard since January 1, 2018, using the modified retrospective method. The Company has completed the assessment and implementation work. Based on the work performed, the adoption of this guidance will not have a material impact on the Company's consolidated financial statements or the Company's internal controls over financial reporting.

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

In January 2016, the FASB issued ASU No. 2016-01 (“ASU 2016-01”), Financial Instruments. ASU 2016-01 requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or in the accompanying notes to the financial statements. That presentation provides financial statement users with more decision-useful information about an entity’s involvement in financial instruments. The guidance is effective for annual periods beginning after December 15, 2017. Early adoption is permitted. The Company is currently evaluating the impact on its consolidated financial statements of adopting this standard.

In February 2016, the FASB issued ASU No. 2016-02 (“ASU 2016-02”), Leases. ASU 2016-02 requires recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases. The guidance is effective for annual periods beginning after December 15, 2018. Early adoption is permitted. The Company is currently evaluating the impact on its consolidated financial statements of adopting this standard.

In November 2016, the FASB issued ASU No. 2016-18 (“ASU 2016-18”), Statement of Cash Flows: Restricted Cash. ASU 2016-18 requires amounts generally described as restricted cash or restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning –of-period and end-of-period total amounts shown on the statement of cash flows. The guidance is effective for annual periods beginning after December 15, 2017. Early adoption is permitted. The Company will adopt ASU 2016-18 on January 1, 2018, and does not expect the adoption of this standard will have a material impact on its consolidated financial statements.

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)**3. Discontinued Operations**

In December 2015, the Company committed to a plan to sell 100% of its equity stake in Tangshan Yian to an unrelated third-party biological technology company, for a total consideration of \$1,872 (RMB 13 million). The transaction represents a strategic shift that the Company was exiting the animal vaccine market and will focus on the human use vaccine market, which will have a major effect on the Company's operations and financial results going forward. As such, the financial results of Tangshan Yian and the gain on disposition are reported within discontinued operations in the consolidated financial statements. The consolidated financial statements and amounts previously reported have been reclassified, as necessary, to conform to this presentation in accordance with *ASC 205, Presentation of Financial Statements* to allow for meaningful comparison of continuing operations. The Company received \$926 (RMB 5.97 million) in January 2016 and the disposition transaction was completed in February 2016 as all other conditions have been fulfilled. The Company recognized gain on the disposition of \$2,461 (net of tax of nil), which represents the excess of (a) the sum of (i) \$2,016 (RMB 13 million) in consideration, consisting of \$1,706 (RMB 11 million) in cash received and \$310 (RMB 2 million) of cash receivable, and (ii) Tangshan Yian's \$1,880 cumulative translation gain, which was reclassified to earnings, over (b) \$1,435 net book value of Tangshan Yian upon the closing of the transaction.

Results of the discontinued operations are summarized as follows:

| | For the year ended December 31, | | |
|--|--|-----------------|-----------------|
| | 2017 | 2016 | 2015 |
| Sales | \$ - | \$ - | \$ 112 |
| Cost of sales | - | - | 406 |
| Gross loss | <u>-</u> | <u>-</u> | <u>(294)</u> |
| Selling, general and administrative expenses | - | 129 | 459 |
| Research and development expenses | - | - | 22 |
| Total operating expenses | <u>-</u> | <u>129</u> | <u>481</u> |
| Operating loss | <u>-</u> | <u>(129)</u> | <u>(775)</u> |
| Other income | - | 6 | 47 |
| Loss from discontinued operations before gain on disposition and provision for income taxes | <u>-</u> | <u>(123)</u> | <u>(728)</u> |
| Gain on disposal of Tangshan Yian | - | 2,461 | - |
| Provision for income taxes | - | - | - |
| Income (loss) from discontinued operations, net of income tax | <u>\$ -</u> | <u>\$ 2,338</u> | <u>\$ (728)</u> |

Income from discontinued operations, net of income tax, for the year ended December 31, 2016 included the results of Tangshan Yian through the disposition date of February 28, 2016.

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)**4. Restricted Cash**

As of December 31, 2017, the balance of \$1,549 (December 31, 2016 – \$3,007) represents cash collateral of \$781 held as a guarantee relating to an EPI (Expanded Program on Immunization) sales contract, which is restricted until June 2018, and \$768 held as a guarantee relating to a bank loan under Sinovac R&D (note 10 (f)).

| | December 31, | |
|------------------------|---------------------|-----------------|
| | 2017 | 2016 |
| Restricted Cash | \$ 1,549 | \$ 3,007 |

5. Accounts Receivable – net

| | December 31, | |
|----------------------------------|---------------------|------------------|
| | 2017 | 2016 |
| Trade receivables | \$ 69,448 | \$ 52,061 |
| Allowance for doubtful accounts | (4,779) | (3,603) |
| | 64,669 | 48,458 |
| Other receivables | 1,536 | 1,374 |
| Total accounts receivable | \$ 66,205 | \$ 49,832 |

Accounts receivables with a carrying value of \$5,379 (RMB 35 million) were pledged as collateral for a bank loan from China Merchant Bank as of December 31, 2017 (note 10 (d)). No accounts receivables were pledged as of December 31, 2016.

The allowance for doubtful accounts reflects the Company's best estimate of probable losses inherent in the accounts receivable balance. The Company estimates the allowance based on known troubled accounts, historical experience, the age of the accounts receivable balances, credit quality of the Company's customers, current economic conditions, and other factors that may affect customers' ability to pay. As of December 31, 2017, the Company provided 100% (December 31, 2016 - 100%) allowance for accounts receivable aged more than four years, approximately 94.6% (December 31, 2016 - 84.8%) allowance for accounts receivable aged between three years and four years, approximately 68.5% (December 31, 2016 - 59.1%) allowance for accounts receivable aged between two years and three years, approximately 15.3% (December 31, 2016 - 20.5%) allowance for accounts receivable aged between one year and two years, and approximately 1.2% (December 31, 2016 - 1.4%) allowance for accounts receivable aged less than one year.

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

The Company's maximum exposure to credit risk at the balance sheets date relating to trade receivables is summarized as follows:

| | December 31, | |
|---|---------------------|------------------|
| | 2017 | 2016 |
| Aging within one year, net of allowance for doubtful accounts | \$ 58,157 | \$ 45,340 |
| Aging greater than one year, net of allowance for doubtful accounts | 6,512 | 3,118 |
| Total trade receivables | \$ 64,669 | \$ 48,458 |

6. Inventories

| | December 31, | |
|--------------------------|---------------------|------------------|
| | 2017 | 2016 |
| Raw materials | \$ 3,298 | \$ 2,251 |
| Work in progress | 3,275 | 1,387 |
| Finished goods | 13,045 | 10,464 |
| Total inventories | \$ 19,618 | \$ 14,102 |

For the year ended December 31, 2017, the Company charged \$2,757 of excessive fixed production overhead to cost of sales (2016 - \$3,232, 2015 - \$2,154).

For the year ended December 31, 2017, cost of sales includes \$1,231 of inventory provision for products that are likely to expire before being sold (2016 - \$6,377, 2015 - \$1,820).

7. Long-term Inventories

| | December 31, | |
|----------------|---------------------|-------------|
| | 2017 | 2016 |
| Finished goods | - | 98 |

Long-term inventories represent H5N1 vaccines with remaining shelf lives over one year and not expected to be sold within one year. These vaccines are for government stockpiling purposes.

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)**8. Property, Plant and Equipment**

| | December 31, | |
|---|---------------------|-------------------|
| | 2017 | 2016 |
| Cost | | |
| Construction in progress | \$ 34,566 | \$ 24,516 |
| Plant and buildings | 30,851 | 28,778 |
| Machinery and equipment | 39,678 | 35,932 |
| Motor vehicles | 1,710 | 1,368 |
| Office equipment and furniture | 2,736 | 2,534 |
| Leasehold improvements | 12,972 | 12,156 |
| Total cost | \$ 122,513 | \$ 105,284 |
| Less: Accumulated depreciation | | |
| Construction in progress | \$ - | \$ - |
| Plant and buildings | 10,380 | 8,754 |
| Machinery and equipment | 24,808 | 20,689 |
| Motor vehicles | 1,333 | 1,202 |
| Office equipment and furniture | 2,000 | 1,871 |
| Leasehold improvements | 7,562 | 5,886 |
| Total accumulated depreciation | \$ 46,083 | \$ 38,402 |
| Property, plant and equipment, net | \$ 76,430 | \$ 66,882 |

The buildings of the Changping facilities of Sinovac Beijing with a net book value of \$11,963 (RMB 77.8 million) were pledged as collateral for bank loans from China Construction Bank (note 10(e), 10 (k)).

The buildings of Sinovac Beijing with a net book value of \$2,076 (RMB 13.5 million) were pledged as collateral for a bank loan from Bank of Beijing (note 10 (j)).

The buildings of Sinovac Dalian with a net book value of \$4,832 (RMB 31.4 million) were pledged as collateral for a bank loan from Bank of China (note 10 (c)), which has been released in February 2018 after the loan was fully repaid in October 2017.

Net depreciation expense for the year ended December 31, 2017 was \$4,638 (2016 - \$5,063, 2015 - \$6,258), after deduction of amortized government grant specifically related to qualified property, plant and equipment.

Loss on disposal of equipment for the year ended December 31, 2017 was \$42 (2016 - \$478, 2015 - \$26).

9. Prepaid Land Lease Payments

| | December 31, | |
|--------------------------------|---------------------|-----------------|
| | 2017 | 2016 |
| Prepaid land lease payments | \$ 11,098 | \$ 10,400 |
| Less: accumulated amortization | 2,070 | 1,703 |
| Net carrying value | \$ 9,028 | \$ 8,697 |

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

Prepaid land lease payments of the Changping facilities of Sinovac Beijing with a net book value of \$2,566 (RMB 16.7 million) were pledged as collateral (note 10 (e), 10(k)) for a bank loan from China Construction Bank.

Prepaid land lease payments of Sinovac Beijing with a net book value of \$307 (RMB 2.0 million) were pledged as collateral (note 10 (j)) for a bank loan from Bank of Beijing.

Prepaid land lease payments of Sinovac Dalian with a net book value of \$3,350 (RMB 21.8 million) were pledged as collateral (note 10 (c)) for a bank loan from Bank of China, which has been released in March 2018 after the loan was fully repaid in October 2017.

Amortization expense for prepaid land lease payments for the year ended December 31, 2017 was \$243 (2016 - \$247, 2015 - \$261).

10. Bank Loans

Summarized below are bank loans as of December 31, 2017 and 2016:

| | December 31, | |
|---|---------------------|------------------|
| | 2017 | 2016 |
| China Merchants Bank (a) | \$ - | \$ 4,321 |
| Bank of Beijing (b) | 3,689 | 7,072 |
| Bank of China (c) | - | 1,440 |
| China Merchants Bank (d) | 3,074 | - |
| China Construction Bank (e) | 2,982 | 9,996 |
| China Construction Bank (f) | 722 | - |
| PingAn Bank (g) | - | 4,321 |
| Citi Bank (h) | 4,611 | 4,129 |
| Industrial and Commercial Bank of China (i) | 3,074 | - |
| Bank loans due within one year | 18,152 | 31,279 |
| Bank of Beijing (j) | 6,851 | 6,420 |
| China Construction Bank (k) | 7,998 | 3,028 |
| Long-term bank loans | 14,849 | 9,448 |
| Total bank loans | \$ 33,001 | \$ 40,727 |

(a) On November 1, 2016, Sinovac Beijing entered into a one-year term bank loan with China Merchants Bank in the aggregate principal amount of \$4,321 (RMB 30 million) to finance its working capital requirements, bearing interest at 15% above the prime rate of a one-year term loan published by the People's Bank of China, at 5.00% per year. Interest is payable quarterly and the loan was repaid on October 30, 2017.

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

(b) On September 18, 2015, Sinovac Beijing entered into a maximum credit facility of \$7,202 (RMB 50 million) with Bank of Beijing to finance its working capital requirements. \$1,368 (RMB 9.5 million) was drawn on April 14, 2016 and \$1,426 (RMB 9.9 million) was drawn on May 25, 2016. These two tranches were repaid on April 14, 2017 and May 25, 2017, respectively. \$1,426 (RMB 9.9 million) was drawn on June 27, 2016 and \$1,426 (RMB 9.9 million) was drawn on July 27, 2016. These two tranches were repaid on June 27, 2017 and July 27, 2017, respectively. \$1,426 (RMB 9.9 million) was drawn on August 30, 2016 and was repaid on August 30, 2017. \$753 (RMB 4.9 million) was drawn on August 29, 2017 and is payable on August 29, 2018. \$784 (RMB 5.1 million) was drawn on September 6, 2017 and is repayable on August 29, 2018. These two tranches bear interest at 4.57% and is payable quarterly. \$1,537 (RMB 10 million) was drawn on October 13, 2017, and is repayable on October 13, 2018. \$615 (RMB 4 million) was drawn on November 9, 2017 and is repayable on October 13, 2018. These two tranches bear interest at 5.00% and is payable quarterly.

(c) On September 26, 2016, Sinovac Dalian entered into a bank loan with Bank of China in the aggregate principal amount of \$720 (RMB 5 million) to finance its working capital requirements. The loan bears interest at 144.2 basis points above the prime rate of a one-year term loan published by the People's Bank of China, at 5.79%. Interest is payable monthly and the loan was repaid on September 26, 2017. On October 12, 2016, Sinovac Dalian entered into a bank loan with Bank of China in the aggregate principal amount of \$720 (RMB 5 million) to finance its working capital requirements. The loan bears interest at 144.2 base points above the prime rate of a one-year term loan published by the People's Bank of China, at 5.79%. Interest is payable monthly and the loan was repaid on October 11, 2017. Prepaid land lease payments and buildings of Sinovac Dalian with a net book value of \$8,182 (RMB 53.2 million) were pledged as collateral, which has been released in February 2018 and March 2018, respectively, after the loans were fully repaid.

(d) On February 23, 2017, Sinovac Beijing entered into a one-year term bank loan with China Merchants Bank in the aggregate principal amount of \$3,074 (RMB 20 million) to finance its working capital requirements, bearing interest at 5% above the prime rate of a one-year term loan published by the People's Bank of China, at 4.57% per year. Interest is payable quarterly. The loan was guaranteed by an unrelated third party, with a guarantee fee of \$59 (RMB 0.4 million) over the term of the loan. Trade receivables of Sinovac Beijing with a carrying value of no less than \$5,379 (RMB 35 million) were pledged as collateral, which has been released after the loan repaid. The loan was repaid on February 22, 2018.

(e) On May 6, 2015, Sinovac Beijing entered into a maximum credit facility of \$17,284 (RMB 120 million), which has been increased to \$30,739 (RMB 200 million) in 2017, with China Construction Bank to finance its working capital requirements.

On March 8, 2016, Sinovac Beijing entered into a bank loan with China Construction Bank in the aggregate principal amount of \$7,202 (RMB 50 million) to finance its working capital requirements, bearing interest at 5% above the prime rate of a one-year term loan published by the People's Bank of China, at 4.57%. \$7,202 (RMB 50 million) was drawn on March 8, 2016. Interest is payable monthly and the loan was repaid on March 7, 2017. On July 26, 2016, Sinovac Beijing entered into a bank loan with China Construction Bank in the aggregate principal amount of \$7,202 (RMB 50 million) to finance its working capital requirements, bearing interest at 5% below the prime rate of a one-year term loan published by the People's Bank of China, at 4.13%. Interest is payable monthly. \$2,218 (RMB 15.4 million) and \$576 (RMB 4 million) were drawn on July 26, 2016 and August 12, 2016, respectively. These two tranches were repaid on July 25, 2017.

On September 5, 2017, Sinovac Beijing entered into a bank loan with China Construction Bank in the aggregate principal amount of \$2,982 (RMB 19.4 million) to finance its working capital requirements, bearing interest at 0.27% above the prime rate of a one-year term loan published by the People's Bank of China, at 4.57%. Interest is payable monthly. \$2,982 (RMB 19.4 million) was drawn on September 5, 2017 and is payable on September 4, 2018. Pursuant to the covenants set out in these two bank loan agreements, Sinovac Beijing's debt to total assets ratio must not be higher than 80%, current ratio must not be lower than 0.8, contingent liabilities must not be higher than \$36,118 (RMB 235 million) and contingent liabilities as a percentage of total shareholders' equity must not be higher than 50%. The Company was in compliance with covenants associated with the loan as of December 31, 2017. Prepaid land lease payment and buildings of the Changping facilities of Sinovac Beijing with a net book value of \$14,529 (RMB 94.5 million) were pledged as collateral against the loan as of December 31, 2017.

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

(f) On March 27, 2017, Sinovac R&D entered into a bank loan with China Construction Bank in the aggregate principal amount of \$722 (RMB 4.7 million) to finance its working capital requirements, bearing an interest at 5% above the prime rate of a one-year term loan published by the People's Bank of China, at 4.43%. Interest is payable monthly and the loan was repaid on March 26, 2018. \$768 (RMB 5 million) of cash was pledged as collateral.

(g) On June 24, 2016, Sinovac Beijing entered into a bank loan with PingAn Bank in the aggregate principal amount of \$4,321 (RMB 30 million) to finance its working capital requirements. The loan bears interest at the prime rate of a one-year term loan published by the People's Bank of China, at 4.35%. Interest is payable quarterly and the loan was repaid on June 24, 2017.

(h) On May 9, 2016, Sinovac Beijing entered into a revolving bank loan with Citi Bank with the aggregate principal limit of \$4,611 (RMB 30 million) to finance its working capital requirements. The revolving loan bears interest at the prime rate of a one-year term loan published by the People's Bank of China, with a weighted average rate at 4.47% and interest is payable quarterly. Each withdraw from the revolving loan has a maximum term of 12 months. \$4,129 (RMB 28.7 million) was drawn during 2016 and remained outstanding as of December 31, 2016, which was repaid in 2017. \$6,820 (RMB 44.4 million) was drawn during 2017 and repaid in the same year. The outstanding balance of \$4,611 (RMB 30.0 million) as of December 31, 2017 was fully repaid in the first quarter of 2018.

(i) On February 27, 2017, Sinovac Beijing entered into a bank loan with Industrial and Commercial Bank of China in the aggregate principal amount of \$3,074 (RMB 20 million) to finance its working capital requirements. The loan bears interest at the prime rate of a one-year term loan published by the People's Bank of China, at 4.35%. Interest is payable quarterly and the loan was repaid on February 27, 2018.

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

(j) On May 20, 2015, Sinovac Beijing entered into a bank loan with Bank of Beijing in the aggregate principal amount of \$7,377 (RMB 48 million) with a term from July 2015 to May 2020 for construction of the pneumococcal polysaccharide vaccine facilities. The loan's interest rate is based on the prime rate of a five-year term loan published by the People's Bank of China at the time withdraws are made. Interest is payable quarterly and the loan is repayable based on the payment schedule and shall be fully repaid before May 20, 2020. \$753 (RMB 4.9 million) was drawn in 2015 with an annual interest rate of 5.25%, and \$6,098 (RMB 39.7 million) was drawn in 2016 with an annual interest rate of 4.75%. Prepaid land lease payments and buildings of Sinovac Beijing with a net book value of \$2,383 (RMB 15.5 million) were pledged as collateral as of December 31, 2017.

(k) On May 6, 2015, Sinovac Beijing entered into a maximum credit facility of \$10,758 (RMB 70 million) with China Construction Bank to finance construction of the Sabin inactivated polio vaccine facilities. On October 14, 2016, Sinovac Beijing entered into a bank loan with China Construction Bank in the aggregate principal amount of \$7,684 (RMB 50 million) with a term from October 2016 to October 2021. The loan bears interest at 5% below the prime rate of a five-year term loan published by the People's Bank of China, adjusted every 12 months, currently at 4.51%. Interest is payable quarterly and the loan is repayable based on the payment schedule and shall be fully repaid before October 13, 2021. \$3,230 (RMB 21.0 million) was drawn in 2016 and \$4,454 (RMB 29.0 million) was drawn in 2017. On August 17, 2017, Sinovac Beijing entered into a bank loan with China Construction Bank in the aggregate principal amount of \$3,074 (RMB 20 million) with a term from August 2017 to October 2021. The loan bears interest at prime rate of a five-year term loan published by the People's Bank of China, adjusted every 12 months, currently at 4.75%. Interest is payable quarterly and the loan is repayable based on the payment schedule and shall be fully repaid before October 21, 2021. \$314 (RMB 2.0 million) was drawn in 2017. \$123 (RMB 0.8 million) and \$191 (RMB 1.2 million) are payable on February 25, 2019 and August 25, 2019, respectively. Pursuant to the covenants set out in these two bank loan agreements, Sinovac Beijing's debt to total assets ratio must not be higher than 80%, current ratio must not be lower than 0.8, contingent liabilities must not be higher than \$36,118 (RMB 235 million) and contingent liabilities as a percentage of total shareholders' equity must not be higher than 50%. The Company was in compliance with such covenants as of December 31, 2017. Prepaid land lease payment and buildings of the Changping facilities of Sinovac Beijing with a net book value of \$14,529 (RMB 94.5 million) were pledged as collateral.

Aggregate maturities of loans for each of the next 5 years following December 31, 2017 are as follows:

| | | |
|---------------|-----------|---------------|
| Within 1 year | \$ | 18,152 |
| In 2019 | | 4,283 |
| In 2020 | | 7,338 |
| In 2021 | | 3,228 |
| In 2022 | | - |
| Total | <u>\$</u> | <u>33,001</u> |

The weighted average interest rate for all short-term and long-term bank loans was 4.61% in 2017 (2016 – 4.73%, 2015 - 4.83%). The weighted average interest rate for short-term loans was 4.51% in 2017 (2016 – 4.73%, 2015 - 5.23%). The Company incurred \$2,171 in interest and financing expenses for the year ended December 31, 2017 (2016 - \$1,841, 2015 - \$2,059), of which \$302 was capitalized in property, plant and equipment for the year ended December 31, 2017 (2016 - \$75, 2015 - \$nil).

11. Related Party Transactions and Balances

(a) Loan from a non-controlling shareholder

| | December 31, | |
|----------------------|---------------------|-----------------|
| | 2017 | 2016 |
| Loan - current | \$ - | \$ 2,304 |
| Loan - non - current | 7,070 | - |
| | <u>\$ 7,070</u> | <u>\$ 2,304</u> |

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

The Company has two loans due to Dalian Jin Gang Group, the non-controlling shareholder of Sinovac Dalian, with a total amount of \$7,070, of which \$4,611 (RMB 30 million) was borrowed on August 23, 2017 and is repayable on August 22, 2020. \$2,459 (RMB 16 million) was borrowed in 2012 and amended from current to long term loan, which is repayable on November 9, 2020. These two loans are unsecured, bearing interest at 6.0% and 7.2% per year, respectively. Interest expense was \$262 in 2017 (2016 - \$176, 2015 - \$183). Interest is payable monthly. As of December 31, 2017, no interest is owed on the loan from the non-controlling shareholder (December 31, 2016 - \$nil). Interests of \$262, \$176 and \$199 were paid to the non-controlling shareholder for the years ended December 31, 2017, 2016 and 2015, respectively.

- (b) The Company entered into the following transactions in the normal course of operations at the exchange amount with related parties:

| | For the year ended December 31, | | |
|---|--|-------------|-------------|
| | 2017 | 2016 | 2015 |
| Rent expenses to SinoBioway Biotech Group Co., Ltd. ("SinoBioway"). | \$ 793 | \$ 807 | \$ 852 |

In 2004, the Company entered into two operating lease agreements with SinoBioway, the parent company of Sinobioway Medicine Co., Ltd. ("Sinobioway Medicine") which is the non-controlling shareholder of Sinovac Beijing, with respect to Sinovac Beijing's production plant and laboratory in Beijing, China with annual lease payments totaling \$201 (RMB 1.4 million). The leases commenced on August 12, 2004 and have a term of 20 years. One of the lease agreements was amended on August 12, 2010 with the rent increasing from \$75 (RMB 0.5 million) to \$201 (RMB 1.4 million) per year.

In June 2007, the Company entered into another operating lease agreement with SinoBioway, with respect to the expansion of Sinovac Beijing's production plant in Beijing, China, for an annual lease payment of \$302 (RMB 2.0 million). The lease commenced in June 2007 and has a term of 20 years.

In September 2010, the Company entered into another operating lease agreement with SinoBioway with respect to expansion of Sinovac R&D's business in research and development activities for an annual lease payment of \$149 (RMB 1.0 million). The lease commenced on September 30, 2010 and has a term of five years.

On April 8, 2013, the Company entered into three supplemental agreements with SinoBioway, under which the expiration date of three of the four operating lease agreements was extended to April 7, 2033.

As of December 31, 2017, \$391 (December 31, 2016 - \$366) in prepaid lease payments made to SinoBioway is included in current and long-term prepaid expenses and deposits.

12. Accounts Payable and Accrued Liabilities

| | December 31, | |
|---|---------------------|------------------|
| | 2017 | 2016 |
| Trade payables | \$ 6,780 | \$ 1,834 |
| Machinery and equipment payables | 2,191 | 3,990 |
| Accrued expenses | 32,620 | 8,597 |
| Value added tax payable | 239 | 289 |
| Other tax payable | 619 | 759 |
| Withholding tax payable | 75 | 163 |
| Bonus and benefit payables | 8,213 | 5,320 |
| Other payables | 8,681 | 4,008 |
| Total accounts payable and accrued liabilities | \$ 59,418 | \$ 24,960 |

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)**13. Income Taxes***Antigua and Barbuda*

Under the current laws of Antigua and Barbuda, the Company is not subject to tax on income or capital gains. Additionally, upon payments of dividends by the Company to its shareholders, no Antigua and Barbuda withholding tax will be imposed.

Hong Kong

Under the Hong Kong tax laws, Sinovac Hong Kong is exempted from income tax on its foreign-derived income and there are no withholding taxes in Hong Kong on remittance of dividends.

China

Effective from January 1, 2008, the PRC's statutory income tax rate is 25%. The Company's PRC subsidiaries are subject to income tax at the statutory rate of 25% except for Sinovac Beijing and Sinovac Dalian. Sinovac Beijing, being reconfirmed as a "High and New Technology Enterprise" ("HNTE") in 2017 for a period of 3 years, is subject to a preferential income tax rate of 15% from 2017 to 2019. Sinovac Dalian, being confirmed as a "High and New Technology Enterprise" ("HNTE") in 2017 for a period of 3 years, is subject to a preferential income tax rate of 15% from 2017 to 2019.

The Company's income (loss) before income tax from continuing operations consists of:

| | For the year ended December 31, | | |
|--------------|--|-----------------|-----------------|
| | 2017 | 2016 | 2015 |
| Non-PRC | \$ (3,123) | \$ (5,323) | \$ (2,052) |
| PRC | 48,167 | 4,929 | 4,808 |
| Total | \$ 45,044 | \$ (394) | \$ 2,756 |

The Company's income (loss) before income tax from discontinued operations consists of:

| | For the year ended December 31, | | |
|--------------|--|-----------------|-----------------|
| | 2017 | 2016 | 2015 |
| Non-PRC | \$ - | \$ - | \$ - |
| PRC | - | 2,338 | (728) |
| Total | \$ - | \$ 2,338 | \$ (728) |

Income taxes that are attributed to discontinued operations in China were \$nil for all the periods presented.

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

Income taxes attributed to the continuing operations in China consist of:

| | For the year ended December 31, | | |
|---------------------------------|--|-------------------|-------------------|
| | 2017 | 2016 | 2015 |
| Current income tax expenses | \$ (13,260) | \$ (3,671) | \$ (3,318) |
| Deferred tax benefits | 4,921 | 1,007 | 333 |
| Total income tax expense | \$ (8,339) | \$ (2,664) | \$ (2,985) |

The following is a reconciliation of the Company's total income tax expenses to the amount computed by applying the PRC statutory income tax rate of 25% to its income from continuing operations before income taxes for the years ended December 31, 2017, 2016 and 2015:

| | For the year ended December 31, | | |
|--|--|-------------------|-------------------|
| | 2017 | 2016 | 2015 |
| Income (loss) from continuing operations before income taxes | \$ 45,044 | \$ (394) | \$ 2,756 |
| Income tax benefit (expense) at the PRC statutory rate | (11,261) | 99 | (689) |
| International tax rate differential | (781) | (1,331) | (513) |
| Super deduction for research and development expenses | 1,257 | 461 | 463 |
| Non-deductible expenses | (577) | (1,141) | (1,512) |
| Other adjustments | (5) | 89 | (98) |
| Effect of preferential tax rate | 5,406 | 1,635 | 1,473 |
| Change in valuation allowance | (2,309) | (2,430) | (1,618) |
| Effect of PRC withholding tax | (69) | (59) | (89) |
| Effect of prior year adjustment and restatement | - | 13 | (402) |
| Income tax expense | \$ (8,339) | \$ (2,664) | \$ (2,985) |

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

The tax effects of temporary differences from continuing operations that give rise to the Company's deferred tax assets are as follows:

| | December 31, | |
|----------------------------|---------------------|-----------------|
| | 2017 | 2016 |
| Inventories | 275 | 697 |
| Accrued expenses | 8,483 | 3,121 |
| Deferred government grants | 684 | 233 |
| Fixed assets | 3,484 | 2,327 |
| Tax losses carried forward | 6,375 | 6,035 |
| Less: valuation allowance | (9,981) | (8,469) |
| Deferred tax assets | \$ 9,320 | \$ 3,944 |

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which the temporary differences become deductible or utilized. The Company considers projected future taxable income and tax planning strategies in making this assessment. Based upon an assessment of the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible or can be utilized, the Company provided valuation allowance of \$9,981 as of December 31, 2017 (December 31, 2016 - \$8,469).

The Company evaluates its valuation allowance requirements at end of each reporting period by reviewing all available evidence, both positive and negative, and considering whether, based on the weight of that evidence, a valuation allowance is needed. When circumstances cause a change in management's judgement about the realizability of deferred tax assets, the impact of the change on the valuation allowance is generally reflected in income from operations. The future realization of the tax benefit of an existing deductible temporary difference ultimately depends on the existence of sufficient taxable income of the appropriate character within the carry forward period available under applicable tax law.

Tax losses of the Company's PRC subsidiaries in the amount of \$25,500 (RMB 166 million) as of December 31, 2017 will expire from 2018 to 2022, if not utilized.

As of December 31, 2017, the Company has not recognized any deferred tax liability on Sinovac Beijing's undistributed earnings of approximately \$76,952, in view of the Company's permanent reinvestment plan. The Company would be subject to PRC withholding income taxes at 5% or 10%, depending on the availability of treaty benefit between China and Hong Kong, upon the distribution of such profits outside of China. As of December 31, 2017, the Company's portion on the amount of unrecognized deferred tax liability was ranging from \$2,812 to \$5,624.

The changes in unrecognized tax benefits are as follows:

| | For the year ended December 31, | | |
|---|--|-----------------|-----------------|
| | 2017 | 2016 | 2015 |
| Balance at January 1 | 1,842 | 2,027 | 1,490 |
| Additions for tax positions of the current year | 271 | 183 | 479 |
| Additions for tax positions of the prior years | - | - | 281 |
| Settlement with the taxing authority | - | - | (107) |
| Lapse of statute of limitations | (240) | (368) | (116) |
| Balance at December 31 | \$ 1,873 | \$ 1,842 | \$ 2,027 |

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

The Company recognizes interest and penalties, if any, related to unrecognized tax benefits as part of its income tax expenses. For the year ended December 31, 2017, the Company recognized \$291 in interest (December 31, 2016 - \$164) and nil in penalties (December 31, 2016 - nil). The Company had \$667 accrued interest as of December 31, 2017 (December 31, 2016 - \$376). The PRC tax law provides statute of limitations ranging from 3 to 5 years and for transfer pricing related matters, it could be extended to 10 years. The PRC tax returns for the Company's PRC subsidiaries are open to examination by tax authorities for the tax years beginning in 2007.

As of December 31, 2017, the Company had unrecognized tax benefits of approximately \$1,873 (December 31, 2016 - \$1,842, December 31, 2015 - \$2,027) and such balance was included in "other non-current liabilities". As of December 31, 2017, unrecognized tax benefits amounting to \$1,873 would affect the effective tax rate if recognized (December 31, 2016 - \$1,842, December 31, 2015 - \$2,027). The Company does not expect the amount of unrecognized tax benefits would change significantly in the next 12 months.

14. Deferred Revenue

Current deferred revenue included \$3,950 of advances from customers (December 31, 2016 - \$2,766) and \$95 and \$28 from Chinese government for stockpiling of H5N1 and hepatitis A vaccines, respectively (December 31, 2016 - nil).

Long-term deferred revenue included \$nil received from the Chinese government for stockpiling of H5N1 vaccines (December 31, 2016 - \$89).

15. Deferred Government Grants

Deferred government grants represent funding received from the government for research and development ("R&D") or investment in building or improving production facility. The amount of deferred government grants as of year end is net of research and development expenditures, deduction of depreciation expenses, and the amount recognized as government grant income. The Company received \$2,306 of government grant in 2017 (2016 - \$753, 2015 - \$236) that were deferred. In addition, the Company received \$292 in other government grants and subsidies for the year ended December 31, 2017 and recognized as income in the statements of comprehensive income (loss) (2016 - \$6,104, 2015 - \$308).

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

Summarized below are deferred government grants as of December 31, 2017 and 2016:

| | December 31, | |
|--|---------------------|-----------------|
| | 2017 | 2016 |
| Construction of a pandemic influenza vaccine plant and buildings (a) | \$ 277 | \$ 259 |
| Purchasing equipment for H1N1 vaccine production (b) | 136 | 128 |
| Purchasing equipment for H5N1 vaccine production (c) | 15 | 14 |
| EV71 commercialization project (d) | 502 | 471 |
| Others (g) | 1,108 | 905 |
| Current deferred government grants | 2,038 | 1,777 |
| Construction of a pandemic influenza vaccine plant and buildings (a) | 291 | 532 |
| Purchasing equipment for H1N1 vaccine production (b) | 57 | 181 |
| Purchasing equipment for H5N1 vaccine production (c) | 15 | 29 |
| EV71 commercialization project (d) | 1,735 | 2,096 |
| EV71 phase IV clinical research (e) | 784 | - |
| Purchasing equipment for sIPV vaccine production (f) | 1,537 | - |
| Others (g) | 55 | 115 |
| Non-current deferred government grants | 4,474 | 2,953 |
| Total deferred government grants | \$ 6,512 | \$ 4,730 |

(a) Deferred government grants included \$568 being the unamortized portion of a grant the Company received in 2007 for construction of a pandemic influenza vaccine plant and buildings (December 31, 2016 - \$791). The Company has fulfilled the conditions attached to the government grant. \$277 which will be amortized in 2018 was included in the current portion of deferred government grants and \$291 which will be amortized after 2018 was included in the non-current portion of deferred government grants. The production facility grant requires the Company to have the entire facility available to manufacture pandemic influenza vaccines at any given moment upon request by the Chinese government. \$266 of government grant relating to these production facilities was recorded as a reduction to depreciation expense for the year ended December 31, 2017 (2016 - \$271, 2015 - \$287).

(b) Deferred government grants included \$193 being the unamortized portion of a grant the Company received in 2009 for purchasing equipment for H1N1 vaccine production. The Company has fulfilled the conditions attached to the government grant. \$136 which will be amortized in 2018 was included in the current portion of deferred government grants and \$57 which will be amortized after 2018 was included in the non-current portion of deferred government grants. \$131 of government grant relating to these production facilities was recorded as a reduction to depreciation expense for the year ended December 31, 2017 (2016 - \$133, 2015 - \$141).

(c) Deferred government grants included \$30 being the unamortized portion of a grant the Company received in 2013 for purchasing equipment for H5N1 vaccine production. The Company has fulfilled the conditions attached to the government grant. \$15 which will be amortized in 2018 was included in the current portion of deferred government grants and \$15 which will be amortized after 2018 was included in the non-current portion of deferred government grants. \$15 of government grant relating to these production facilities was recorded as a reduction to depreciation expense for the year ended December 31, 2017 (2016 - \$15, 2015 - \$16).

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

(d) Deferred government grants included \$2,237 being the unamortized portion of a grant the Company received in 2015 for equipment purchase and construction of the enterovirus 71 (“EV71”) vaccine production facility. The Company has fulfilled the conditions attached to the government grant in 2016. \$502 which will be amortized in 2018 was included in the current portion of deferred government grants and \$1,735 which will be amortized after 2018 was included in the non-current portion of deferred government grants. \$403 of government grant relating to these production facilities was recorded as a reduction to depreciation expense for the year ended December 31, 2017 (2016 - \$274, 2015 - \$nil), and \$80 was recorded as government recognized in income for the year ended December 31, 2017 (2016 - \$55, 2015 - \$nil).

(e) Deferred government grants included \$784 being the unamortized portion of a grant the Company received in 2017 for phase IV clinical research for EV71 vaccine. As of December 31, 2017, the Company has not fulfilled the conditions attached to the government grant. As the Company does not expect to fulfill the conditions within one year, the grant is recorded as a non-current deferred government grant.

(f) Deferred government grants included \$1,537 being the unamortized portion of a grant the Company received in 2017 for purchasing equipment for sIPV vaccine production. As of December 31, 2017, the Company has not fulfilled the conditions attached to the government grant. As the Company does not expect to fulfill the conditions within one year, the grant is recorded as a non-current deferred government grant.

(g) As of December 31, 2017, conditions attached to a government grant received in 2017 in the amount of \$78 for certain production facilities were fulfilled, of which \$19 will be amortized in 2018 and \$55 will be amortized after 2018, and \$4 of government grant relating to these production facilities was recorded as a reduction to depreciation expense for the year ended December 31, 2017. As of December 31, 2017, conditions of four government grants totaling \$1,089 have not been fulfilled by the Company. The Company expects to fulfill the conditions of the four grants within one year, and these grants totaling \$1,089 were included in the current portion of deferred government grants.

16. Commitments and Contingencies**(a) Operating Lease Commitments**

The Company leases production plant and laboratory under operating leases from its related parties (note 11(b)). Rental expense amounted to \$793 for the year ended December 31, 2017 (2016 - \$807, 2015 - \$852).

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

Minimum future rental payments under operating leases to related parties for the years ending December 31 are as follows:

| | | |
|-------------------------------|----|--------------|
| 2018 | \$ | 427 |
| 2019 | | 793 |
| 2020 | | 793 |
| 2021 | | 793 |
| 2022 | | 793 |
| Thereafter | | 6,381 |
| Total minimum future payments | \$ | <u>9,980</u> |

(b) Other Commitments

In addition to commitments disclosed in note 23, commitments related to R&D expenditures are \$2,158 as of December 31, 2017.

Commitments related to capital expenditures for the Company's Sabin inactivated polio vaccine and varicella vaccine production facilities are approximately \$112 as of December 31, 2017.

(c) Foreign Corrupt Practice Act Matters

The Company may be subject to legal proceedings, investigations and claims relating to the conduct of the Company's business from time to time.

The Beijing People's Court issued five judgements in 2016 and 2017. These judgments were related to corrupt conduct allegedly engaged in by a former official of the Center for Drug Evaluation in CFDA, his wife and his son. These judgments found that the official and his wife had engaged in a practice of improperly soliciting and accepting payments from various individuals involved in the vaccine products industry. According to the judgments, one of the individuals solicited by the official was Mr. Weidong Yin, the Company's chairman, president and chief executive officer. It was asserted in the judgments that Mr. Weidong Yin made three payments, and arranged for a loan, to the official and his wife, in the total amount of \$77 (RMB 0.6 million) between 2002 and 2011. Mr. Weidong Yin was not charged with any offense or improper conduct and he cooperated as a witness with the procuratorate. To the Company's knowledge, the Chinese authorities have not commenced any legal proceedings or government inquiries against Mr. Yin. In December 2016, our audit committee authorized the commencement of an internal investigation into the allegations made in the judgements. The audit committee engaged Latham & Watkins as independent counsel to assist with the investigation.

In addition, the Company became aware of certain judgments based on bribery charges issued by Chinese courts in four provinces against various officials of the Chinese Center for Disease Control (the "CDC"). While these judgments appear to reflect an industry-wide investigation focused on CDC officials, they also referenced nine of the Company's former sales persons, together with sales personnel from several other Chinese vaccine companies and distributors. These judgments did not name, and no charges were brought against, the Company or any of its directors or officers as defendants. To the best of our knowledge, the nine referenced employees cooperated with the procuratorate. The procuratorate did not contact the Company for cooperation. Upon becoming aware of these judgments, the audit committee expanded its internal investigation to review matters related to these judgments and the Company's sales practices and policies, and further engaged Latham & Watkins to continue the independent investigation with the expanded scope. Recently, the Company became aware that one of the nine former sales employees has been convicted for giving bribes. The judgment states that this former sales person took these actions without knowledge of the Company. His criminal penalty was waived by the court. The Company has also learned that another one of the nine former sales employees is currently being investigated by the procuratorate.

After the Company publicly announced the internal investigation arising from the allegations in a research report in December 2016, the Company was notified by the SEC in February 2017 of an enforcement inquiry related to the matters discussed in the report, and in April 2017 the Company received a subpoena from the SEC requesting documents. In September 2017, the Company received an inquiry from the Department of Justice (the "DOJ") and the Company has been cooperating with the DOJ. The SEC and DOJ have requested information regarding the judgments discussed above, and the Company is cooperating with these requests.

Also in February 2017, the Company received an inquiry from NASDAQ related to the same matter. Further, in May 2018, the Company received an inquiry from NASDAQ requesting information related to the actions by Sinobioway and their impact on the Company's operations and financial reporting. The Company has cooperated with both of these NASDAQ inquiries.

The Company takes these matters very seriously and is committed to conducting business in compliance with all applicable laws. However, at this time, the Company is unable to predict, what, if any, action may be taken by NASDAQ, the SEC and the DOJ or any penalties or remedial measures these agencies may seek, but intend to continue to cooperate with these agencies. Any determination that our operations or activities are not in compliance with existing laws or regulations could result in the imposition of fines, civil and criminal penalties, and equitable remedies, including disgorgement or injunctive relief. The Company cannot determine as to whether an ultimate unfavorable outcome is either probably or remote, nor reasonably estimate the amount or range of the potential liability, if any, related to these matters resulting from any proceedings that may be commenced by the SEC or any other governmental authorities.

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

On July 3, 2017, a securities class action complaint was filed in the U.S. District Court for the District of New Jersey against the Company and three of its current and former officers: Mr. Weidong Yin, the Company's current chief executive officer, Ms. Nan Wang, the Company's current chief financial officer, and Mr. Danny Chung, the Company's former chief financial officer. The complaint asserts that statements in the Company's annual filings for fiscal years 2012 through 2015 were false and misleading because they failed to disclose matters relating to the alleged bribery incidents, among other allegations. On September 6, 2017, the plaintiff has filed the notice of voluntary dismissal. The Court granted the dismissal without prejudice.

(d) Other Litigation Matters

On July 12, 2017, an alleged shareholder of the Company filed a putative class action complaint in the Supreme Court of the State of New York against the Company, its directors, and certain entities. The complaint alleges that the Company's directors breached their fiduciary duties by, among other things, entering into a going-private transaction at a price below fair value and failing to take steps to maximize the value of the Company. The complaint also alleges that the Company aided and abetted those alleged breaches of fiduciary duty. The complaint seeks, among other things, an injunction preventing completion of the going-private transaction, damages (including rescissory damages) in favor of the plaintiff, and the fees and costs associated with the litigation. So far, none of the defendants, including the Company and certain director, have been served. The Company is vigorously defending this lawsuit; however, the Company cannot determine as to whether an ultimate unfavorable outcome is either probably or remote, nor reasonably estimate the amount or range of the potential liability for this case at this stage.

On March 5, 2018, the Company filed a lawsuit in the Court of Chancery of the State of Delaware seeking a determination whether 1Globe, The Chiang Li Family, OrbiMed and other shareholders of the Company had triggered our Rights Plan by forming a group holding approximately 45% of the Company's outstanding shares, in excess of the plan's threshold of 15%, and acting in concert prior to the 2017 Annual General Election ("the AGM"). Our Rights Plan is intended to promote the fair and equal treatment of all Sinovac shareholders and ensure that no person or group can gain control of Sinovac through undisclosed voting arrangements, open market accumulation or other tactics potentially disadvantaging the interest of all shareholders.

On April 12, 2018, 1Globe filed an amended answer to the Company's complaint, counterclaims, and a third-party complaint against Mr. Weidong Yin alleging, among other allegations, that our Rights Plan is not valid, that Mr. Weidong Yin and the Buyer Consortium had previously triggered our Rights Plan, and that 1Globe did not trigger our Rights Plan. The Company and its board of directors believes that the actions taken by the board of directors were appropriate under the circumstances and that the allegations of the counterclaim and third-party complaint are without merit. 1Globe asks for various measures of equitable relief and also includes a claim for its costs, including attorneys' fees. This litigation is currently in the pre-trial phase with a decision expected before the end of 2018, subject to appeal. The Company cannot predict whether an ultimate outcome will be favorable or unfavorable, nor estimate the amount or range of potential loss (if any) at this time.

On March 5, 2018, the Company also filed a lawsuit in the United States District Court for Massachusetts alleging violations of Section 13(d) of the Securities Exchange Act of 1934 by 1Globe and The Chiang Li Family. The lawsuit alleges, among other things, that the defendant shareholders failed to make required disclosures on Schedule 13D regarding their intentions to attempt to replace the Company's board of directors. The Company is vigorously pursuing this lawsuit; however, the Company cannot predict whether an ultimate outcome will be favorable or unfavorable, nor estimate the amount or range of potential loss (if any) at this time.

On April 9, 2018, the Company received a document request from SEC requesting all of the Company's documents concerning 1Globe, the Chiang Li Family, OrbiMed, certain other shareholders, and their affiliates. The Company has been cooperating with the SEC. The Company understands the SEC is investigating whether 1Globe, and possibly other shareholders, violated the U.S. securities laws. The Company does not have any information to suggest the SEC is investigating the actions of the Company or its officers and directors.

On March 13, 2018, 1Globe filed a complaint against the Company in the Eastern Caribbean Supreme Court in the High Court of Justice, Antigua and Barbuda, or the Antigua Court. The complaint seeks a declaration that the five persons purportedly proposed on its alternative ballot at the 2017 AGM were elected as directors of the Company at that meeting, an order of the Antigua Court that those directors be installed as the Company's board of directors, and a declaration that any actions taken on behalf of the Company at the direction of the board of directors since the 2017 AGM are null and void. On April 10, 2018, 1Globe filed a notice of application in the Antigua Court seeking an order declaring the result of the disputed election, an urgent order restraining the Company's board of directors from acting, pending determination of the dispute, including acting to initiate or continue litigation against the Shareholder Group, and other related relief. The Company is vigorously defending this lawsuit; however, the Company cannot predict or estimate an outcome or economic burden for this case at this time. Hearings in this litigation are scheduled for May 9 and 18, 2018.

On April 4, 2018, Sinovac Hong Kong filed a complaint against Sinovac Beijing in the Haidian District Court of Beijing. The complaint seeks a declaration that the board resolutions dated February 6, 2018 purporting to appoint Mr. Aihua Pan as the general manager of Sinovac Beijing are invalid. On May 9, 2018, Sinobiway Medicine filed a complaint against Sinovac Beijing in the Haidian District Court of Beijing. The complaint seeks a declaration that the board resolutions passed on February 28, 2018 to appoint Mr. Weidong Yin and other senior management members are invalid. As of the date of this report, both lawsuits are pending and no hearing has been held. The Company cannot predict whether an ultimate outcome will be favorable or unfavorable, nor estimate the amount or range of potential loss (if any) at this time.

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

17. Common Stock

Share Capital

Each share of common stock is entitled to one vote per share and is entitled to dividends when declared by the Company's board of directors. As of December 31, 2017 and 2016, there were 57,281,861 and 57,011,761 shares of common stock outstanding, respectively. As of December 31, 2017 and 2016, there was no preferred stock issued and outstanding.

In 2015, the Company issued 115,500 shares of common stock on the exercise of employee stock options with exercise price of \$1.60 per share and 252,400 shares of common stock on the exercise of employee stock options with exercise price of \$2.37 per share, for total proceeds of \$732. The Company received further cash proceeds of \$18 on the exercise of stock option for which the shares were issued subsequent to December 31, 2015. In May 2015, the Company granted 729,000 restricted shares at par value of \$0.001 for total proceeds of \$1 to directors, officers and employees of the Company.

In 2016, the Company issued 101,600 shares of common stock on the exercise of employee stock options with exercise price of \$2.37 per share and 18,400 shares of common stock on the exercise of employee stock options with exercise price of \$4.98 per share, for total proceeds of \$315. In 2016, the Company cancelled 14,800 restricted shares previously issued to employees of the Company due to employee termination.

In 2017, the Company issued 31,000 shares of common stock on the exercise of employee stock options with exercise price of \$2.37 per share and 239,100 shares of common stock on the exercise of employee stock options with exercise price of \$4.98 per share, for total proceeds of \$1,264. The Company received further cash proceeds of \$428 on the exercise of stock option in 2017 with the shares issued subsequent to December 31, 2017.

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)**18. Stock Options****(a) Stock Option Plan**

The board of directors approved a stock option plan (the “2003 Plan”) effective on November 1, 2003, pursuant to which directors, officers, employees and consultants of the Company are eligible to receive grants of options for the Company’s common stock. The 2003 Plan expires on November 1, 2023. Up to 10% of the Company’s then outstanding common stocks were reserved for issuance under the 2003 Plan. As of December 31, 2016, 42,800 shares of common stock under the 2003 Plan remain available for issuance. Each stock option entitles its holder to purchase one share of common stock of the Company. Options may be granted for a term not exceeding 10 years from the date of grant. The 2003 Plan is administered by the board of directors.

In December 2011, the Company granted 767,000 options to employees with an exercise price of \$2.37, being the quoted market price of the Company’s shares at the time of grant. 10% of the options vest every three months from December 26, 2012 to March 26, 2015 and expired on December 25, 2017. This grant was fully vested on March 26, 2015.

On August 22, 2012, the board of directors approved a new stock option plan (the “2012 Plan”), which allowed the Company to issue up to 4,000,000 options for common shares and restricted shares of the Company to directors, officers, employees and consultants of the Company. Each stock option entitles its holder to purchase one share of common stock of the Company. Options and restricted shares may be granted for a term not exceeding 10 years from the date of grant. The 2012 Plan is administered by the board of directors. The 2012 Plan will expire on August 22, 2022. Any awards that are outstanding on August 22, 2022 will remain in force according to the terms of the 2012 Plan and the applicable award agreement.

On May 1, 2015, the Company granted 729,000 restricted shares (the “Restricted Shares”) at par value of \$0.001 and 1,341,000 options (the “Options”) under the 2012 Plan with an exercise price of \$4.98, being the quoted market price of the Company’s shares at the time of grant. The options will expire on April 30, 2023. One-fifth of the Restricted Shares and Options shall vest on the first, second, third, fourth and fifth anniversaries of date of grant, respectively. The Restricted Shares are not subject to any restriction on transfer and repurchase after they are vested. 20% of the Options and Restricted Shares were vested on May 1, 2016. On December 16, 2016, the board of directors approved that an additional 30% of the Options to be vested on December 16, 2016, and restrictions of an additional 30% of the Restricted Shares were removed on December 16, 2016. The vesting period, vesting schedule and all other terms for the unvested Options and Restricted Shares remained unchanged. A total of 80 employees were impacted by this modification, and incremental share-based compensation expense was \$1,145 for the year ended December 31, 2016. The Company revised the estimated forfeiture rate from 7% to 4% as a result of this modification, and additional options and restricted shares are expected to be vested with an additional \$199 in share-based compensation expense to be recognized by the Company over the remaining vesting period.

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

(b) Valuation Assumptions

The following assumptions were used in determining the fair value of stock options under the Black-Scholes option-pricing model for grants under the 2012 Plan:

| | <u>2017</u> | <u>2016</u> | <u>2015</u> |
|---------------------------|-------------|-------------|-------------|
| Expected volatility | - | - | 51.42% |
| Risk-free interest rate | - | - | 1.5% |
| Expected life (years) | - | - | 5.5 |
| Dividend yield | - | - | 0% |
| Estimated forfeiture rate | - | - | 7% |

There was no stock option granted for the years ended December 31, 2017 and 2016. The weighted average fair value of options granted in 2015 was \$2.37.

Expected volatility is estimated based on the Company's historical stock prices. Computation of expected life was estimated using simplified method for "plain-vanilla" options as the Company considers the options granted to have "plain-vanilla" characteristics. The risk-free interest rates for the period within the contractual life of the awards are based on the U.S. Treasury yield in effect at the time of grant. Estimated forfeiture rates are determined based on expected future employee behavior.

The fair value of restricted shares is based on the fair market value of the underlying common stock on the date of the grant.

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

(c) Share-based Payment Award Activity

A summary of the Company's stock options activity for the 2003 and 2012 Plan is presented below:

| | Number of Options | Weighted Average Exercise Price (\$/option) | Aggregate Intrinsic Value (\$) |
|--|------------------------------|--|---|
| Outstanding as of January 1, 2017 | 1,336,400 | \$ 4.91 | \$ 1,328,146 |
| Granted | - | - | - |
| Exercised | (270,100) | 4.68 | - |
| Forfeited / Expired | (37,800) | 4.51 | - |
| Outstanding as of December 31, 2017 | <u>1,028,500</u> | <u>\$ 4.98</u> | <u>\$ 2,982,650</u> |
| Vested and expected to vest at December 31, 2017 | <u>1,287,360</u> | <u>\$ 4.98</u> | <u>\$ 3,733,344</u> |
| Exercisable as of December 31, 2017 | <u>545,125</u> | <u>\$ 4.98</u> | <u>\$ 1,580,863</u> |

A summary of the Company's non-vested restricted share activity for the 2012 plan is presented below:

| | Number of Non-Vested Restricted shares | Weighted Average Grant Date Fair Value (\$) |
|------------------------------------|---|--|
| Non-vested as of January 1, 2017 | 349,700 | \$ 4.98 |
| Granted | - | - |
| Vested | (77,700) | 4.98 |
| Forfeited | - | 4.98 |
| Non-vested as of December 31, 2017 | <u>272,000</u> | <u>\$ 4.98</u> |

As at December 31, 2017

| Exercise Prices (\$/option) | Number of Options Outstanding | Remaining Average Contractual Life (years) | Average Exercise Price (\$/option) | Number of Options Exercisable | Remaining Contractual Life (years) | Average Exercise Price (\$/option) |
|--|--|---|---|--|---|---|
| \$ 4.98 | <u>1,028,500</u> | 5.33 | \$ 4.98 | <u>545,125</u> | 5.33 | 4.98 |
| | <u>1,028,500</u> | 5.33 | 4.98 | <u>545,125</u> | 5.33 | \$ 4.98 |

Share-based compensation expense, included in cost of sales, selling, general and administrative expenses and R&D expenses is charged to operations over the vesting period of the options using the straight-line amortization method. The share-based compensation expense was \$979 in 2017 (2016 - \$2,409, 2015 - \$952). As of December 31, 2017, there was \$1,220 and \$1,065 of unrecognized compensation cost related to non-vested stock options and non-vested restricted shares, respectively, granted under the 2012 Plan, which will be recognized over a weighted average period of 40 months, respectively.

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

The aggregate intrinsic value of the Company's stock options is calculated as the difference between the exercise price of the options and the quoted price of the common shares that were in the money. The aggregate intrinsic value of the Company's stock options exercised under the 2003 Plan and the 2012 Plan was \$162 and \$699 for year ended December 31, 2017, respectively, determined as of the date of option exercise (2016 - \$386, 2015 - \$1,118).

The estimated fair value of stock options vested during the year ended December 31, 2017 was \$384 (2016 - \$1,567, 2015 - \$104).

19. Statutory surplus reserves

Pursuant to Chinese company law applicable to foreign investment companies, the Company's PRC subsidiaries are required to maintain statutory surplus reserves. The statutory surplus reserves are to be appropriated from net income after taxes, and should be at least 10% of the after tax net income determined in accordance with accounting principles and relevant financial regulations applicable to PRC enterprises ("PRC GAAP"). The Company has an option of not appropriating the statutory surplus reserve after the statutory surplus reserve is equal to 50% of the subsidiary's registered capital. Statutory surplus reserves are recorded as a component of shareholders' equity. The statutory surplus reserve as of December 31, 2017 is \$19,549 (2016 - \$14,788).

Sinovac R&D, Sinovac Dalian and Sinovac Biomed have not made any profit since inception. No appropriation to the statutory surplus reserves and staff welfare and bonus were made.

Dividends declared by the Company's PRC subsidiaries are based on the distributable profits as reported in their statutory financial statements reported in accordance with PRC GAAP, which differ from the results of operations reflected in the consolidated financial statements prepared in accordance with US GAAP. The Company's ability to pay dividends is primarily dependent on the Company receiving distributions of funds from its PRC subsidiaries. The Company has not declared any dividends to the shareholder of Sinovac Beijing in 2017, 2016 and 2015. As of December 31, 2017, the Company has \$nil dividend payable (December 31, 2016 - \$nil).

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

Under PRC laws and regulations, statutory surplus reserves are restricted to set-off against losses, expansion of production and operation and increasing registered capital of the respective company, and are not distributable other than upon liquidation. Staff welfare and bonus funds are restricted to expenditures for the collective welfare of employees. The reserves are not allowed to be transferred to the Company in terms of cash dividends, loans or advances, nor are they allowed for distribution except under liquidation. Amounts restricted include the PRC subsidiaries' paid-in capital and statutory surplus reserves of the Company's PRC subsidiaries totaling \$68,353 (RMB 473 million) as of December 31, 2017 (December 31, 2016, \$63,592 (RMB 440 million)). Further, foreign exchange and other regulations in the PRC further restrict the Company's PRC subsidiaries from transferring funds to the Company in the form of loans, advances or cash dividends. As of December 31, 2017, amounts restricted include the net assets of the Company's PRC subsidiaries, which amounted to \$116,365 (December 31, 2016 - \$71,552).

20. Non-controlling Interests

Non-controlling interests represent the interest of non-controlling shareholders in Sinovac Beijing and Sinovac Dalian based on their proportionate interests in the equity of that company adjusted for its proportionate share of income or losses from operations. On October 1, 2016, the Company increased its ownership in Sinovac Dalian by an additional 12.86% by converting debt owed by Sinovac Dalian in the amount of \$12,772 (RMB 80 million). Non-controlling interest in Sinovac Dalian was 45% prior to October 1, 2016, and was 32.14% after October 1, 2016.

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)**21. Earnings (loss) per Share**

The following table sets forth the computation of basic and diluted income (loss) attributable to shareholders of Sinovac per share:

| | For the year ended December 31 | | |
|--|---------------------------------------|-------------------|-------------------|
| | 2017 | 2016 | 2015 |
| Numerator | | | |
| Income (loss) from continuing operations | 36,705 | (3,058) | (229) |
| Less: Income (loss) attributable to non-controlling interests | 10,898 | (124) | 459 |
| Income (loss) attributable to shareholders of Sinovac from continuing operations | 25,807 | (2,934) | (688) |
| Income (loss) attributable to shareholders of Sinovac from discontinued operations | - | 2,338 | (728) |
| Net income (loss) attributable to shareholders of Sinovac | <u>25,807</u> | <u>(596)</u> | <u>(1,416)</u> |
| Denominator | | | |
| Basic weighted average number of common shares outstanding | 57,033,816 | 56,949,083 | 56,313,927 |
| Dilutive effect of stock options | 67,375 | - | - |
| Diluted weighted average number of common shares outstanding | <u>57,101,191</u> | <u>56,949,083</u> | <u>56,313,927</u> |
| Basic net income (loss) per share | | | |
| Continuing operations | 0.45 | (0.05) | (0.02) |
| Discontinued operations | - | 0.04 | (0.01) |
| Basic net income (loss) per share | <u>0.45</u> | <u>(0.01)</u> | <u>(0.03)</u> |
| Diluted net income (loss) per share | | | |
| Continuing operations | 0.45 | (0.05) | (0.02) |
| Discontinued operations | - | 0.04 | (0.01) |
| Diluted net income (loss) per share | <u>0.45</u> | <u>(0.01)</u> | <u>(0.03)</u> |

Anti-dilutive options and non-vested restricted shares were not included in the diluted EPS calculation for the year ended December 31, 2016 and 2015.

22. Segment Information

The Company operates exclusively in the biotechnology sector. The Company's business is considered as operating in one segment. The Company's Chief Executive Officer is the chief operating decision maker and reviews the consolidated results of operations when making decisions about resources allocation and assessing performance of the Company as a whole. All revenues are generated from the subsidiaries located in China. Total long-lived assets of \$85,458 including prepaid land lease payments, property, plant and equipment are all located in mainland China (December 31, 2016 - \$75,579). The Company's total assets by geographic location are as follows:

| | December 31, | |
|---------------------|---------------------|-------------------|
| | 2017 | 2016 |
| Assets | | |
| Mainland China | \$ 289,560 | \$ 196,276 |
| Hong Kong | 9,659 | 15,079 |
| Total Assets | <u>\$ 299,219</u> | <u>\$ 211,355</u> |

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

The Company's revenues by product are as follows:

| | For the year ended December 31, | | |
|--------------------------------|--|------------------|------------------|
| | 2017 | 2016 | 2015 |
| Sales | | | |
| Inactivated hepatitis vaccines | \$ 37,851 | \$ 20,596 | \$ 49,416 |
| Influenza vaccines | 13,544 | 9,829 | 12,674 |
| Enterovirus 71 vaccines | 121,284 | 35,140 | - |
| H5N1 | - | 6,389 | 3,852 |
| Mumps | 1,667 | 477 | 1,472 |
| Total Sales | \$ 174,346 | \$ 72,431 | \$ 67,414 |

The H5N1 vaccines were all sold to the Chinese government. The Company's sales of H5N1 vaccines are dependent on government stockpiling purchases.

The Company's revenues are attributed to geographic locations as follows:

| | For the year ended December 31, | | |
|--------------------|--|------------------|------------------|
| | 2017 | 2016 | 2015 |
| Sales | | | |
| Mainland China | \$ 172,897 | \$ 71,184 | \$ 66,779 |
| Foreign countries | 1,449 | 1,247 | 635 |
| Total Sales | \$ 174,346 | \$ 72,431 | \$ 67,414 |

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)**23. Collaboration Agreements**

- (a) On March 12, 2009, the Company entered into a technology transfer agreement (with an amendment agreement entered into on December 14, 2011) with Tianjin CanSino Biotechnology Inc. (“Tianjin Cansino”). According to the agreement, Tianjing Cansino will transfer the technology related to pneumococcal vaccine to the Company and jointly develop the technology with the Company. The collaboration term under the technology transfer agreement is from March 12, 2009 to eight years after the first sale of the vaccine developed under the technology transfer agreement in the Chinese market.

Under the terms of the technology transfer agreement, the Company will make milestone payments of up to \$3,000 and royalty payments ranging from 6% to 10% of net sales in China. Both parties will work together to develop international markets for the products. On November 17, 2009 and December 14, 2011, two amendment agreements were signed for the payment of \$300 for the transfer of an additional six serotypes and related technology. As of December 31, 2016, the Company made total milestone payments of \$1,200 (\$1,000 under the March 12, 2009 agreement and \$200 under the December 14, 2011 amendment). The remaining milestone payments will be paid when the Company achieves each specific milestone, which includes obtaining clinical trials approval, completing clinical trials and achievement of desired results, and achievement of commercial sales.

On January 29, 2015, the Company entered into a third amendment to the technology transfer agreement dated March 12, 2009 and the two amendment agreements dated November 17, 2009 and December 24, 2011. By entering into this third amendment, the technology transfer agreement was revised to be a licensing agreement. The remaining milestone and royalty payments under the technology transfer agreement have been reduced. Both the Company and Tianjin Cansino are free to develop pneumococcal vaccines or to collaborate with one other company for the same purpose. The Company made a payment and recorded \$nil, \$300 and \$300 in research and development expenses for the years ended December 31, 2017, 2016 and 2015, respectively.

- (b) On August 18, 2009, the Company entered into a patent license agreement with the National Institutes of Health (“NIH”), an agency of the United States Public Health Services within the Department of Health and Human Services. NIH has granted the Company a non-exclusive license to make and use certain of its products. NIH has also granted the Company the right to use certain associated information for development of its licensed products. The collaboration term under the patent license agreement is from August 18, 2009 to the later of (a) the expiration of all royalty obligations under the licensed rights where such rights exist and (b) eight years after the first commercial sale by the Company, unless the agreement is terminated earlier per the provisions included therein.

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

The Company has agreed to pay NIH a license issue royalty of \$80 upon execution of the agreement and a non-refundable minimum annual royalty of \$8, and royalty payments on net sales ranging from 1.5% to 4% depending on the sales territory and the customers. The Company has also agreed to pay NIH benchmark royalties of \$330 upon achieving each benchmark as specified in the patent license agreement, including completion of clinical trials, obtaining regulatory approval for marketing, and achievement of commercial sales. The Company recorded a license issue royalty of \$nil for the year ended December 31, 2017 as R&D expenses (2016 - \$nil, 2015 - \$9).

- (c) On August 15, 2011, the Company licensed from Medimmune, LLC, a US based pharmaceutical company, certain non-exclusive rights to use patented reverse genetics technology pertaining to H5N1 influenza virus strain production for vaccines. The Company has agreed to pay an upfront license fee and milestone payments of up to an aggregate of \$9.9 million based upon achievement of cumulative net sales of licensed products in China (including Hong Kong and Macau), as well as royalty payments in single digit of net sales of the licensed products in China (including Hong Kong and Macau). License fee and royalties of \$3,400 accrued at the end of 2011 were paid in 2012. In 2013, the Company obtained a new stockpile order of 3 million doses of H5N1 vaccines from the Chinese government. For the year ended December 31, 2013, royalties of \$1,036 was capitalized as inventory costs and included in accounts payable and accrued liabilities, which was paid in May 2014. No royalties were incurred for the years ended December 31, 2017 and 2015, respectively. The Company accrued a royal payment of \$8 as of December 31, 2016, which was paid in 2017.

On August 15, 2012, the Company entered into amendment agreements with Medimmune, LLC to revise the termination date of the main license agreement to December 29, 2015.

- (d) On April 3, 2014, the Company entered into a non-exclusive license agreement (the "Agreement") with The Institute for Translational Vaccinology ("INTRAVACC"), a governmental institute working under the Dutch Ministry of Public Health, Welfare and Sports, to develop and commercialize the Sabin Inactivated Polio Vaccine ("sIPV") for distribution in China and other countries. The Company expects to develop and commercialize the vaccine in China, as well as seeking regulatory approval in other countries. The agreement has a term of 50 years.

The Company has agreed to pay INTRAVACC up to \$2,406 (€1.5 million), net of PRC tax, including an entrance fee and milestone payments upon achieving specific milestones. The Company has also agreed to pay royalty payments in a single digit percentage of net sales generated worldwide from the product or products developed under the Agreement. The Company recorded an entrance fee of \$665 (€0.5 million) for the year ended December 31, 2014 as research and development expense. The Company also recorded \$125 (€94) for payment made to INTRAVACC for use of sIPV viral seeds in R&D expenses for the year ended December 31, 2014. There was no expense incurred or paid to INTRAVACC for the year ended December 31, 2017 and 2015. The Company recorded a milestone fee of \$568 (€0.5 million) for the year ended December 31, 2016 as research and development expense.

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

- (e) In September 2015, Sinovac Dalian entered into a technology transfer and supply agreement with GlaxoSmithKline Biologicals SA, or GSK, to use GSK's measles seeds to develop combination vaccines containing measles for the China market. Under this agreement, GSK agreed to transfer its measles seeds, provide reasonable assistance and relevant technical materials to Sinovac Dalian for the purpose of developing and producing combination vaccines containing measles. The Company made a payment of \$87 for purchasing measles seeds to GSK for the year ended December 31, 2017 (2016 - \$84).

24. Subsequent Events

On March 7, 2018, the Company granted 2,000,000 restricted shares (the "Restricted Shares") at par value of \$0.001 under the 2012 Plan, to certain officers and employees of the Company. 60% of the Restricted Shares will vest on the third anniversary of the date of grant, the remaining 40% Restricted Shares will vest on the fourth and the fifth anniversary evenly.

On April 25, 2018, the board of directors approved that all remaining unvested Options and Restricted Shares that were granted on May 1, 2015 to be fully vested on April 25, 2018.

On March 26, 2018, the Company amended the amalgamation agreement entered into on June 26, 2017 (the "Amalgamation Agreement") to extend its termination date to April 26, 2018. On April 26, 2018, the Company further amended the Amalgamation Agreement to extend its termination date to May 26, 2018.

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

25. Condensed Financial Information of the Parent Company**Balance Sheets**

| | December 31, | |
|--|---------------------|-------------------|
| | 2017 | 2016 |
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 2,140 | \$ 813 |
| Prepaid expenses and other receivables | 478 | 405 |
| Amount due from subsidiaries | 71,097 | 69,635 |
| Dividend receivables | 21,280 | 21,280 |
| Total current assets | 94,995 | 92,133 |
| Investment in subsidiaries | 72,046 | 35,210 |
| Total assets | \$ 167,041 | \$ 127,343 |
| LIABILITIES AND EQUITY | | |
| Current liabilities | | |
| Accrued expenses and other payables | \$ 1,943 | \$ 1,056 |
| Amount due to subsidiaries | 13,946 | 10,520 |
| Total current liabilities | 15,889 | 11,576 |
| Total liabilities | \$ 15,889 | \$ 11,576 |
| EQUITY | | |
| Preferred stock | - | - |
| Authorized 50,000,000 shares at par value of \$0.001 each Issued and outstanding: nil | | |
| Common stock | 57 | 57 |
| Authorized: 100,000,000 shares at par value of \$0.001 each Issued and outstanding: 57,281,861 (2016 –57,011,761) | | |
| Additional paid-in capital | 115,339 | 112,668 |
| Accumulated other comprehensive income | 7,075 | 168 |
| Retained earnings | 28,681 | 2,874 |
| Total shareholders' equity | 151,152 | 115,767 |
| Total liabilities and equity | \$ 167,041 | \$ 127,343 |

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)**Statements of Comprehensive Income (Loss)**

| | For the year ended December 31 | | |
|--|---------------------------------------|--------------------------|--------------------------|
| | 2017 | 2016 | 2015 |
| Selling, general and administrative expenses | <u>4,267</u> | <u>5,434</u> | <u>1,813</u> |
| Total operating expenses | <u>4,267</u> | <u>5,434</u> | <u>1,813</u> |
| Loss from operations | <u>(4,267)</u> | <u>(5,434)</u> | <u>(1,813)</u> |
| Other expenses | - | - | (5,053) |
| Interest income | <u>145</u> | <u>382</u> | <u>413</u> |
| Equity earnings of subsidiaries, net of tax | 29,929 | 2,118 | 5,037 |
| Gain on disposal of subsidiary | <u>-</u> | <u>2,338</u> | <u>-</u> |
| Net income (loss) | 25,807 | (596) | (1,416) |
| Other comprehensive income (loss), net of tax of nil | | - | - |
| Foreign currency translation adjustments | <u>6,907</u> | <u>(8,014)</u> | <u>(3,844)</u> |
| Total comprehensive income (loss) | <u>\$ 32,714</u> | <u>\$ (8,610)</u> | <u>\$ (5,260)</u> |

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)**Statements of Cash Flows**

| | For the year ended December 31 | | |
|---|---------------------------------------|---------------|----------------|
| | 2017 | 2016 | 2015 |
| Cash flows provided by (used in) operating activities | | | |
| Net income (loss) | \$ 25,807 | \$ (596) | \$ (1,416) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | | |
| - Gain on disposal of subsidiary | - | (2,338) | - |
| - Share-based compensation | 119 | 293 | 202 |
| - Equity in earnings of subsidiaries | (29,929) | (2,118) | (5,037) |
| Changes in: | | | |
| - Amount due from subsidiaries | (602) | (171) | 2,914 |
| - Prepaid expenses and other receivables | (73) | (335) | (61) |
| - Amount due to subsidiaries | 3,426 | 5,042 | 1,900 |
| - Accrued expenses and other payables | 887 | 390 | 82 |
| Net cash provided by (used in) operating activities | (365) | 167 | (1,416) |
| Cash flows provided by financing activities | | | |
| - Proceeds from issuance of common stock, net of share issuance costs | 1,264 | 315 | 732 |
| - Proceeds from shares subscribed | 428 | - | 18 |
| Net cash provided by financing activities | 1,692 | 315 | 750 |
| Increase (decrease) in cash and cash equivalents | 1,327 | 482 | (666) |
| Cash and cash equivalents, beginning of year | 813 | 331 | 997 |
| Cash and cash equivalents, end of year | \$ 2,140 | \$ 813 | \$ 331 |

(a) Basis of presentation

The condensed financial information has been prepared using the same accounting policies as set out in the accompanying consolidated financial statements except that the Company used the equity method to account for investment in its subsidiaries.

The Company records its investment in its subsidiaries under the equity method of accounting. Such investment is presented on the balance sheets as "Investment in subsidiaries" and share of their income (loss) as "Equity earnings (losses) of subsidiaries" in the statements of comprehensive income (loss).

Each of the Company's PRC subsidiaries has restrictions on its ability to pay dividends to the Company under PRC laws and regulations (Note 19). The subsidiaries did not pay any dividends to the Company for the years presented.

SINOVAC BIOTECH LTD.

Notes to Consolidated Financial Statements

(Expressed in thousands of U.S. dollars, unless otherwise stated)

Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted by reference to the consolidated financial statements.

(b) Commitments

The Company does not have any significant commitments or long-term obligations as of any of the periods presented, except for those disclosed in the consolidated financial statements (notes 16 and 23).